The Impact of External Funding on SMEs Performance: A Case of SMEs In Lagos State, Nigeria

Wehnam Peter Dabale[1]

[1] Africa University, Zimbabwe

Correspondence: Wehnam Peter Dabale, Africa University, 1 Fairview Road, P.O Box 1320 Mutare, Zimbabwe. E-mail: dabalew@africau.edu

Received: September 25, 2023 Accepted: November 19, 2023 Online Published: November 30, 2023

doi:10.5430/bmr.v13n1p38 URL: https://doi.org/10.5430/bmr.v13n1p38

Abstract

Introduction: This study attempts to ascertain the practical importance of Transaction Cost Theory by providing a theoretical and empirical backdrop to its applicability in a framework for utilizing external funding and the performance of small and medium enterprises. The academic focus of this study is substantial and sheds light on the strategic positions that SMEs take in the external funding process. It has been found that the principles of Transaction Cost Economics influence the functions.

Purpose: A study was conducted to test the effectiveness of the Transaction Cost Economics Theory in a framework for small and medium enterprises to utilize external funding and improve their performance.

Methodology: A cross-sectional survey of SMEs in the manufacturing sector in Lagos State, Nigeria, was conducted. The study adopted Path Analysis to uncover the impact of external funding on SMEs' performance.

Findings: The empirical results suggest that the availability of external funding for SMEs is informed by the size of SMEs as measured by intangible and tangible resources. The study presents a regulatory framework that affects the ease of doing business. The lack of external funding options is a direct result of this situation.

Recommendation: The study recommends that policy initiatives support and enable efficiency in the regulatory framework to enhance the ease of doing business and inevitably influence the accessibility of external funding.

Keywords: External funding, Small and Medium Enterprises (SMEs), transactional cost theory, performance, tangible and intangible resources

1. Introduction

One of the primary obstacles faced by small and medium enterprises (SMEs) in their pursuit of expansion is the limited availability and accessibility of external finance sources, which play a crucial role in driving the overall growth and performance of these firms. The size and capital structure of SMEs impact the ability of business companies to obtain equity and debt capital, or a combination of funding sources, to support the firm's growth objectives. Numerous scholarly investigations have examined the dimensions of small and medium-sized firms (SMEs) and the implications of financial regulations on their access to capital. These studies aim to ascertain the primary determinants that impact small and medium-sized enterprises (SMEs). These worries also include how small and medium-sized businesses (SMEs) can lower the costs of getting external funding from banks and the costs of doing business within the value chains of manufacturing SMEs (Corse, 1937; Williamson, 2010). Both their internal resources and external financial regulations impact the availability and accessibility of external funding sources for small and medium-sized enterprises (SMEs). While SMEs' resources and capacities play a crucial role in determining the availability of external funding, empirical and theoretical research indicates that other factors, such as interest rates and macroeconomic conditions, also contribute to the ease of accessing funding (Elaian, 2016; Eniola, 2018; Nazir et al., 2021). The availability and accessibility of external capital to small and medium-sized enterprises (SMEs) can be considerably influenced by financial market circumstances, particularly transaction costs (Demirgüç-Kunt & Maksimovic, 2012). Transaction costs can impact the deterministic nature of the decision to utilize external sources of finance and the firm-level choices that influence the efficiency and efficacy of value chain streams. In the past, scholarly research (Corse, 1937; Williamson, 1990) has concentrated chiefly on firm-level factors, including limited rationality, asset specificity, and opportunism, as the primary drivers of firm-level behavior and as indicators of the fundamental nature of the

organization. According to the original study by Corse (1937) and subsequent works such as Williamson (1990), as well as other contemporary echoes of transaction cost economics, At the firm level, the efficiency of firms is argued to be crucial in determining their performance and growth. The primary objective of this study is to examine the notion of transaction-cost economics by delving into two essential topics. The primary focus pertains to the resources possessed by firms at the organizational level, which facilitate the acquisition of external funding sources and internal capabilities, hence facilitating the firm's expansion at the same level. The second factor is the regulatory framework, which plays a crucial role in enabling organizations to gain access to external sources of funding.

Consequently, this research endeavor aims to provide valuable insights and enhance the knowledge of the demographic above about alternative financial resources available to them. The findings of this study additionally unveiled the determinants that contributed to the sub-optimal performance of external funding and identified their areas of deficiency. This work contributes to the existing body of knowledge and is an essential reference for other scholars investigating closely connected subjects. Moreover, the results of this study have the potential to provide valuable insights for policy formulation and practical implementation within the respective domains.

1.1 Literature Analysis

The current debate can be analyzed through three relevant theoretical frameworks. The Transaction Cost Economic Theory, formulated by Coase in 1937, is the foundational framework for understanding interest. The Transaction Cost Economics (TCE) hypothesis posits that transactions have additional costs encompassing a range of activities, including negotiation, information acquisition, coordination of actions, monitoring of progress, and enforcement of contracts. The second theoretical framework, contract theory, examines the process by which business actors make contractual agreements, particularly in situations characterized by an imbalance of knowledge. The presence of asymmetric information arises when there is a disparity in the information held by the various parties engaged in a business transaction. It leads to one side requiring more knowledge to make a precise and well-informed decision. The Financial Market Theory postulates that financial markets facilitate efficient capital mobilization and investment by offering diverse financial instruments and products.

1.1.1 Transaction Cost and External Funding

Coase (1937), cited in Rindfleisch (2019), presented the concept of transaction costs accompanied by negotiation, information, coordination, monitoring, and contract enforcement. Using the transaction costs encountered by firms as a basis, Coase (1937) conceived the natural development of intermediary firms to reduce these costs. In recent times, significant literature has been dedicated to discussing the transaction costs linked to agriculture markets. Expanding on Coase (1937), Rindfleisch (2019) classified the various parts of transaction costs concerning the transaction as follows: negotiation costs as the physical cost of performing the transaction; checking costs as costs incurred in guaranteeing the adherence to the terms of the transactions; and information costs as costs that emanate before the trade. Transaction cost theory originates from the contemporary view of the firm (Rindfleisch, 2019). The transaction-cost perspective suggests that trading is mainly related to information. This includes communication and sharing of information, leading to the trading of products and services, as well as relationship management between the parties concerned. Consequently, participants in a transaction look for new and creative ways to reduce the costs of communicating, acquiring, and accessing information for pre-trade, trade, and post-trade purposes (Rindfleisch, 2019).

The transaction cost theory focuses on allocating transactions or economic activities across different methods of organization (bureaus, firms, and markets), with the firm at one end and the market at the other. Transaction costs can be described as the "friction" evident in many production units in a cooperative firm (Gedajlovic & Carney, 2010). This implies that friction leads to costs when transactions are conducted among specified actors. Depending on the context, different factors can encourage conflict in the trade. For Instance, they are incorporated into business markets' hierarchy or organizational settings. Transaction costs are 'the costs of running an economic system, friction in the economic system, information imperfections, moving from ignorance to omniscience, reducing uncertainty, and carrying out exchange' (Laffont & Martimort, 2009).

The new transaction cost economics literature usually emphasizes asset specificity, uncertainty, and frequency of transactions as the primary sources of commerce.

Uncertainty signals that contract parties need complete information on the current situation and the probability that the other party will develop opportunistic behavior. The prediction of fate is expensive. According to Rindfleisch (2019), more information about market conditions for managers and product quality for buyers is needed when conducting profitable transactions.

Asset specificity refers to the extent to which a firm's investments have a limited range of practical and economically valuable applications. Managers and business owners of a specific asset in a particular contract arrangement have little or no value in terms of alternative use. Therefore, as asset specificity increases, so does the incentive to enter into a contract to protect assets.

The frequency of exchange refers to the frequency of trade. The transaction cost is high when the transaction frequency is low and vice versa. Therefore, contract arrangements between managers and business owners help minimize costs to make the contract arrangement attractive to the two parties.

In contract theory, Rindfleisch (2019) describes two primary forms of transaction costs. The first is the ex-ante transaction cost, such as finding a contract partner, negotiating terms, drafting, safeguarding, and monitoring the agreement. The second is ex-post transaction cost, which encompasses the expenses incurred to settle a dispute, such as spillover costs and legal fees, into a firm's activities and pricing levels.

It is essential to consider where per-unit costs can be reduced during production and contracting (Gedajlovic & Carney, 2010). Gedajlovic and Carney (2010) identify several approaches to reducing transaction costs, such as investment in physical market infrastructure and better coordination among value chain actors, which allows traders to contract larger volumes, thereby reducing trading costs, investment in transport infrastructure and transport costs. As economic institutions, contract practices can help reduce uncertainty, ensure that firms specialize and invest in specific assets, and increase exchange frequency (Rindfleisch, 2019). The contract can be used to respond to cost reductions when external funding is sourced.

1.1.2 Information Asymmetries in Financial Markets

Contract theory examines how business actors construct contractual arrangements, generally in the presence of information asymmetry. Asymmetric information arises when one party engaged in a business transaction has different information from the other party, so the other party fails to make an accurate decision. This study's contract theory encompasses the principal-agent and transaction cost theories (Laffont and Martimort, 2009). Contract theories have been used in SME financing to explain how decision-makers' behavior under specific numerical utility structures influences SMEs to identify optimal capital structure decisions (Jegede and Yunisa, 2019).

A contract's primary functions include minimizing the coordination transaction costs, providing incentives (including penalties), and risk-sharing. Therefore the contract design includes contract menus, various tools including incentives and risk-sharing mechanisms, the option for renegotiation, repeated contracting, and streamlined and transparent contract terms.

1.1.3 Types of Financial Instruments

Financial markets refer to the financial sector and institutions where financial instruments, securities, or assets are intermediated and traded. Financial markets facilitate easy access to funds and capital and provide investment opportunities in different financial instruments and products. Financial markets make it easy to obtain investments in financial instruments, sell them, and manage risks by diversifying financial instruments or markets. According to Nawrocki and Viole (2014), the financial sector mainly consists of the money market (banking sector or banks) and capital markets (bond and stock markets). Financial products, instruments, or securities are traded in money and capital markets. The most common instruments traded in the money market are treasury bills (T-bills), commercial paper (CP), negotiable certificates of deposits (NCDs), and repurchase agreements (Repos). Banks are usually referred to as authorized dealers of money-market instruments or securities. Banks are institutions where short-term debt securities or agents with a maturity of a specified period, usually one year or less, are issued and traded.

The functions of banks in any economy include: first, banks perfect the information challenges between investors and borrowers by monitoring borrowers, as well as ensuring proper use of depositors' funds. Second, banks provide intertemporal leveling of risk that cannot be diversified at a given time and give depositors insurance against unforeseen consumption shocks. Third, banks contribute to the progress of an economy through their pivotal role in intermediation. In addition, the relative importance of the different functions of banks varies significantly across countries and times; however, banks are always central to the financial system (Johnson, 2017).

The primary purpose of the banking sector is to provide or finance the short-term working capital requirements of businesses and provide the government with short-term funding. Therefore, progress is essential for the prosperity of any economy. This is because the banking sector is considered a primary provider of credit to the private sector to facilitate productive activities (Johnson, 2017). Banks are the leading financial intermediaries in many developing economies. Therefore, banking sector development is significant in promoting access to financial services, and the growth of the banking sector is an integral component of the financial industry. Although most developing countries

focus primarily on the development of the banking sector, the 2007- 2008 global financial crisis taught valuable lessons, focusing solely on the banking sector alone (Vogel, 2018). The severe impact of the financial crisis on finance, banks, and development sent strong signals to policymakers, development partners, regulators, and researchers regarding the need to show interest in and pay keen attention to the development of inclusive capital markets.

Financial market theories define how the cost-efficient reorganization of capital across business entities can boost a nation's economic fortunes as they decrease the barrier to investing in long-term projects (Johnson, 2017). For example, shareholders can transfer significant risks related to long-term investments in an inclusive stock market. Typically, banks provide most of the financing that private firms and investors must establish and grow their businesses (Vogel, 2018). Although a new firm may list for liquidity or raise capital from the capital market, for most firms, it is after they are reasonably established and matured that they consider a listing on the capital market to raise long-term financing through equity or debt instruments to boost their capital status, as well as to heighten their image. Consequently, countries with well-developed banking sectors tend to have well-developed capital markets (Dorn, 2016).

Finance is a critical requirement in economic and production activities. According to Dorn (2016), the financial sector must facilitate mobilization, payments, and finance allocation for productive activities. Thus, the financial industry is responsible for channeling funds from surplus units to deficit units (intermediating) to aid economic transactions, investments, and productive activities in every economy. Financial market theories describe the conditions necessary for effective intermediation. Mai (2011) maintains that access to finance is only a significant problem with transaction costs, uncertainty, or asymmetric information.

Access to external finance is frictionless and limited only by borrowers' inter-temporal wealth constraints. This implies that a borrower's intertemporal preferences and investment opportunities determine their choice between borrowing and lending (Dorn 2016). Thus, decisions to accumulate savings, make payments, and grant loans are equally open to all, and their application costs are lower. This implies that financial systems will not be needed to mobilize savings, facilitate payments, or allocate loans if savers (surplus units) can quickly identify and assign their savings directly to borrowers (deficit units) based on perfect knowledge of investment possibilities.

Therefore, changes in borrowing and lending may only reflect changes in demand and investment opportunities rather than changes in the case of access. To enhance trading in capital markets, it would be beneficial to provide incentives for corporate and business entities that aim to obtain long-term capital from bond and stock markets instead of solely relying on money or credit markets, such as banks. Suppose financial systems are liquid and accessible through their own fund mobilization and capital accumulation. In that case, they will transpire through the widespread and efficient allocation of resources for productive activity and affordable external finance costs, among other factors. This claim is supported by Mai's empirical study (2011). They contend that at the industry level, financial development reduces the cost of external financing to firms. An efficient financial sector can enhance technological innovation, intermediation, capital accumulation, and economic duvet.

In contrast, an inefficient financial sector can limit existing firms' financial capacity, inhibiting their sustainability prospects and ability to take advantage of economies of scale. Furthermore, financial intermediaries mobilize savings efficiently. In this sense, stock markets provide a platform for investors to control their savings easily. Finally, financial intermediaries help increase specialization. Increasing specialization encourages transaction costs to be low (Johnson, 2017). By plummeting transaction costs, stock markets stimulate the economy's field and growth. Stock market funding differs fundamentally in terms of the contractual agreements between bank credit and corporate debt. For example, repayments are contingent on project performance. Johnson (2017) asserts that contractual arrangements stimulate economic activity at both the intensive (increase in scale) and extensive margins (new firms) by being less binding during bad times.

Financial market theories enhance the supply of the long-term capital needed to finance entrepreneurs, housing, infrastructure, and other development projects. The capital supplied by the money market is short-term and needs to match the financial needs of tasks that can accelerate economic growth. Therefore, economic growth in developing countries may be restricted by the prominence of money markets. At a good time, the focus shifted to financial markets. This shift occurs because of the symbiotic relationship between the financial markets and intermediaries (Nawrocki and Viole, 2014).

A strong capital market combined with macroeconomic stability attracts potential investors. Thus, financial development encourages both domestic and foreign capital investments. The absence of a developed domestic financial system harms the economy because it promotes capital flights (Johnson, 2017). Vogel (2018) settled the financial structure argument when he found no evidence to support financial intermediaries or markets. However, empirical evidence supports the role of the financial sector in economic development. The market-based school of thought

emphasizes how to solve problems in bank-based financial systems. Although banks have been found to outperform markets in the early stages of development, this study does not seek to promote division of the financial sector. Mai (2011) argues that the essential requirement for growth is the availability and supply of funds, measured through financial depth.

Rindfleisch (2019) proposed that a low level of financial development may contribute to Africa's poor entrepreneurial performance. A low level of savings translates to low levels of financial intermediation. Thus, there is a need to examine other sectors of the financial system using funds that can be used to invest in entrepreneurial ventures. Rindfleisch (2019) states that an independent central bank developed securities markets and that the banking sector and stable monetary arrangements are vital to achieving this goal. The financial system components of developing countries, especially those in sub-Saharan Africa, must be improved.

First, sufficient capital must be available to the production sector for sustainability (Mai, 2011). The quantity and composition of an economy's financial assets can induce economic growth. Financial intermediation generates a higher return on investment and thus promotes growth. Income growth also plays a role in the demand for financial services. Davidson (2017) discussed the relationship between actual economic activity and financial development as financial intermediation and found that capital formation is crucial in facilitating economic development. Davidson (2017) suggested that financial growth, in terms of financial deepening and greater physical access, is beneficial for poverty reduction. Ultimately, as indicated by Davidson (2017), an improved domestic financial sector will attract and sustain the yields of economic liberalization, which has been the focus of SSA countries since the 1980s.

However, Davidson (2017) contends that, in reality, financial systems are characterized by several market imperfections; that is, information in the real world could be better and cost less. This introduces familiar principal-agent contracts and incentive problems such as adverse selection and moral hazards. Mai (2011) believes that financial market imperfections and information asymmetry play central roles in economic development by influencing critical decisions regarding access to finance. For the financial sector to play a significant role in the development process, attention must be devoted to mobilizing and adequately allocating funds to make financial institutions deep, liquid, accessible, and efficient. Hence, to determine the effectiveness of the financial market as an external funding source, the efficient market hypothesis, modern portfolio theory, and post-modern portfolio theory are vibrant models that describe the financial market as a prerequisite for business growth (Johnson, 2017; Davidson 2017; Mai, 2011; Nazir et al., 2021).

2. Methodology

This study adopted a Path Analysis to uncover the impact of external funding on SMEs' performance in the Lagos State of Nigeria using quantitative research. Creswell and Creswell (2017) assert that a quantitative research design involves collecting data that can be quantified and subjected to statistical treatment to support or refute "alternate knowledge claims." Quantitative research follows a positivist philosophy and assumes an objective, measurable reality. It employs deductive reasoning to test hypotheses.

2.1 Data Collection

The study collected primary data from SMEs in Lagos State's four local government areas. The researchers conducted a survey utilizing closed-ended questionnaires to gather data from a sample of 340 participants. This sample included participants from various roles with small and medium-sized firms (SMEs), such as managers, owners, and employees. Additionally, financial institutions that offer loans to SMEs were also included in the study. The study spanned from 2018 to 2022, during which systematic sampling techniques were employed to choose participants with at least five years of operational experience in business using a simple random sampling procedure.

2.2 Motivation of Study Variables

The research variables were used to capture this phenomenon. Following the literature review and analysis, the following study variables were adopted.

- Performance: This variable attempts to uncover firm-level growth imperatives. Thus, firm-level performance is a proxy for profitability, firm size, and heterogeneity. This variable explains the influence of solid performance on external funding sources.
- Intangible Resources attempt to uncover intangible SME traits such as goodwill, skills, and ownership structure. This variable seeks to explain the influence of intangible resources on the accessibility to external funding.

- Tangible Resources: This variable attempts to uncover discernible SME traits such as SME size. This variable sought to explain the influence of altitude on the accessibility of external funding sources.
- Overdraft: This variable reveals the accessibility of overdrafts as a source of external funding and their relative impact on SMEs' performance. This variable is treated as both dependent and explanatory on the firm-level performance.
- Loans attempt to uncover their accessibility as sources of external funding and their relative impacts on SMEs' performance. This variable is treated as both dependent and explanatory on the firm-level performance.
- Commercial Paper: This variable attempts to reveal the accessibility of commercial paper as a source of external funding and its relative impact on SMEs' performance. This variable is treated as both dependent and explanatory on the firm-level performance.
- The debt attempts to uncover accessibility as a source of external funding and its impact on SMEs' performance. This variable is treated as both dependent and explanatory on the firm-level performance.
- Policy: This variable attempts to uncover the influence of policy regulations in making external funding accessible to SMEs and capturing market inefficiencies in the money and capital markets, such as information asymmetries.

2.3 Data Analysis

This study adopted a Partial Least Squares (PLS) approach to estimate the relationship between and. According to Hair et al. (2011), in a PLS path-modeling approach, the structural model illustrates the relationships among latent variables as multiple regressions.

$$\xi_j = \beta_{j0} + \sum_i \beta_{ji}\xi_i + v_j$$

where ξ_j represents endogenous variables, ξ_i represents exogenous latent variables and $\beta_{ji}$are path coefficients that measure the relationship between the study variables.

For Instance, in PLS path modeling, two types of theories are required to develop path models: measurement theory and structural theory. As such, measurement theory specifies how study variables are related in the structural model, and process measurement theory establishes each variable. Therefore, in the analysis, the arrangement of the structural model was strongly supported by the view at the model specification stage. This study adopted PLS path modeling to uncover the relationship between the study variables, as deduced from the literature review and analysis. The imposed conditions were as follows:

$$E\left(\xi_j/\xi_i = \sum_i \beta_{ji}\xi_i\right)$$

Nonetheless, if there is no linear relationship between the dependent and explanatory variables, this relationship can be mathematically expressed as

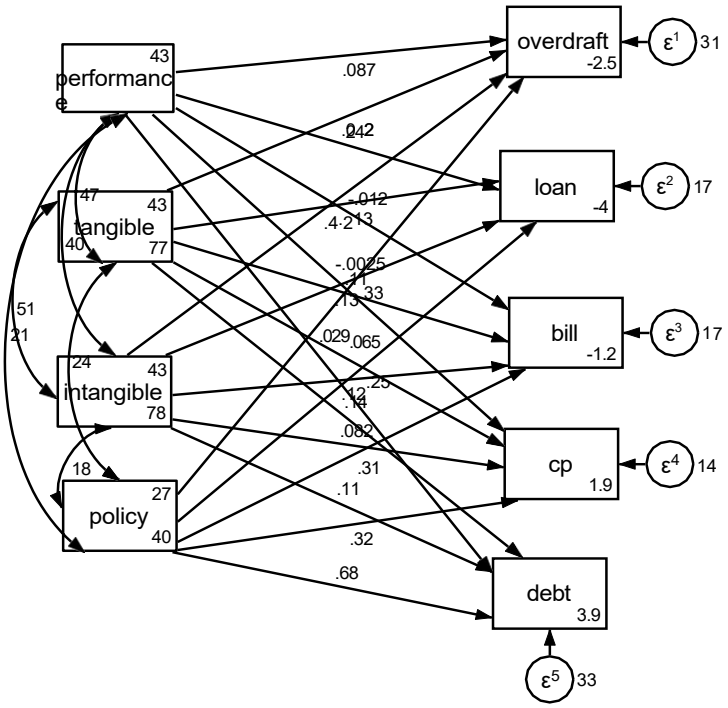
$$E\left(\mathrm{v}_j/\forall\xi_{ji} = 0\right) \text{ and } cov\left(\mathrm{v}_j, \xi_i = 0\right)$$

Furthermore, in PLS equation modeling, the measurement model describes the relationship between the latent (ξ_i) and manifest (X_{ih}) variables in two ways. First, Mode A was used to detect endogenous latent variables. Mode B was used to detect exogenous variables and was more appropriate for the formative measurement model (Hair et al., 2011).

3. Results

The researchers employed path analysis as a statistical technique to examine the causal relationship between the dependent and explanatory variables (Hair et al., 2011). As the extant literature indicates, the theoretical framework posits that variations in organizational performance, tangible assets, and intangible factors exert causal influences on overdrafts, loans, commercial papers, policies, debt, and bills. The findings of the path analysis are displayed in Table 1, while Figure 1 illustrates the graphical representation of the path analysis.

.



Path analysis was conducted in this study to determine the causal relationships between the study variables. In econometrics, causal analysis reveals the causes and effects of a particular event, phenomenon, or situation. This study examined the relationship between at least two possibilities. This study used causal analysis to understand the variables that have causal effects on the accessibility of external funding by SMEs in Nigeria. The dependent variables are informed by external sources of financing available to SMEs in Nigeria: commercial papers, loans, bills, overdrafts, and debt capital. The explanatory variables are firm-level variables such as organizational performance, intangible resources, tangible resources, and policy initiatives that support the accessibility of external funding.

The empirical evidence in this study indicates that in the dependent overdraft explanatory variables, loan, performance, tangible, intangible, and policy have a positive linear relationship; however, this relationship is not statistically significant. Similar results were observed for the dependent variable, loan. Only the explanatory variable overdraft in this series records a negative causal relationship. In contrast, other explanatory variables, such as performance, tangible resources, intangible resources, and policy initiatives, record a positive causal effect that is not statistically significant.

Furthermore, the evidence for the bill-dependent variable suggests that loans have an inverse relationship with the dependent variable. The explanatory variables of performance, tangible and intangible resources, and policy initiatives have a positive relationship and are not statistically significant. Empirical evidence indicates that accessibility to loans has an inverse relationship with the dependent variable, namely, commercial paper. Nonetheless, all the other explanatory variables have a positive relationship with the dependent variable, which is not statistically significant. For the debt-dependent variable, evidence suggests that all explanatory variables are positive and statistically insignificant, indicating the causal impact of the explanatory variables on the dependent variable. In summary, the evidence in this study suggests that explanatory variables do not have a causal effect on dependent variables.

4. Discussion

This section presents a synopsis of recommendations from the literature and primary evidence, as deduced from econometric estimations, and seeks to inform policy recommendations. For Instance, the evidence in this study suggests that SMEs' overriding motives are growth imperatives. To achieve this, SMEs require funding to boost their firm-level operations, with internal funding being the best investment source. However, given the size of SMEs, it isn't easy to raise funds through ordinary share structures or internal investments. Often, SMEs rely on external sources of funding for firm-level operations, which, by their very nature, are difficult to access, given SMEs' resource intensity. Given these challenges, the present study recommends that the government intervene in the factor markets of SMEs to influence the regulatory framework of accessing external funding. The government must improve its credit lines to facilitate access to credit.

The findings indicate a causal relationship between external finance availability, company performance, and resource endowments, including tangible and intangible resources. The results presented in this study align closely with those of several previous studies, as documented in the existing literature. For instance, Zeitun and Saleh (2015) investigate the correlation between the debt of Gulf Cooperation Council (GCC) enterprises and their financial performance in the context of the 2008 financial crisis and recession. It was observed in the study that receiving external funding affects the performance of enterprises. In contrast to the earlier findings of Ebel Ezeoha (2008), Rajan and Zingales (1995), and Titman and Wessels (1988), Shyam-Sunder and Myers (1999) have discovered a positive correlation between earnings and debt financing. However, Akinlo and Asaolu (2012) reported a negative correlation between profits and debt in Nigerian enterprises. Specifically, as the level of debt increases, firm profitability tends to drop, and conversely, as debt falls, profitability tends to increase.

Furthermore, findings suggest that agency conflicts may lead to adopting a high-debt policy, resulting in a decline in performance. This result defies the predictions of the Jensen and Meckling (1976) agency-cost theory, which holds that a higher level of debt can improve market value and performance. The findings of this study suggest a considerable negative correlation between both short- and long-term debt and financial performance. The outcomes presented here support the "pecking order" theory put forth by Myers and Majluf (1984) and Yazdanfar and Ohman's (2015) findings that the use of debt financing has a negative impact on business performance. The research results reported in previous studies by Ebaid (2009), Habib et al. (2016), and Nadeem et al. (2016) are consistent with the findings presented in this study.

Several recommendations can be made from the policy perspective. This study suggests a regulatory framework that affects the ease of doing business. This inevitably affects the accessibility of external funding sources. To overcome this challenge, policy initiatives should improve the regulatory framework to make it more efficient. This will make it easier for businesses to operate and ultimately increase their access to external funding. This study suggests that policy initiatives should improve the regulatory framework to make it more efficient. This will help to make it easier for businesses to operate and ultimately increase their access to external funding. Furthermore, the evidence suggests that there are challenges in monitoring the implementation of government interventions intended to make the accessibility of external funding sources relatively easy for SMEs. Therefore, this study recommends implementing a monitoring mechanism to support existing policy initiatives.

5. Conclusion

This study highlights the existing regulatory constraints that present significant barriers to the growth of small firms, impeding their ability to secure external funding from financial institutions. The substantial initial expenses associated with establishing new businesses, such as obtaining licenses and fulfilling registration obligations, continue to impact small and medium-sized enterprises (SMEs) significantly. Additionally, various econometric estimates and qualitative analyses show a clear connection between these organizations' financial performance and their ability to access external funding. Based on the presented evidence, two arguments suffice. Firstly, the available research indicates that the success of small and medium-sized enterprises (SMEs) enhances their likelihood of securing external finance; Small and medium-sized enterprises (SMEs) face limited opportunities for securing external financing due to their below-average performance.

Consequently, small and medium-sized enterprises (SMEs) that exhibit robust organizational performance receive heightened attention, adaptability, and preferential treatment from the financial regulatory system. Small and medium-sized enterprises (SMEs) should adopt appropriate performance measures to enhance the likelihood of securing external funding. SMEs that obtain long-term financing are subject to a minimum cash outflow in the form of interest payments, which can contribute to the establishment of credibility for new businesses. Based on the available information, we recommend emphasizing policy actions that focus on establishing regulatory frameworks that enable more accessible access to diverse kinds of external finance, including loans and commercial paper.

Funding

The authors personally funded this study.

Ethical Compliance

All procedures performed in this study involving human participants were by the ethical standards of the institutional and national research committee and the 1964 Helsinki Declaration and its later amendments or comparable ethical standards.

Conflict of Interest

The authors of this study state that they have no conflict of interest. They confirm that this work is original and solely created by them.

References

Coase, R. H. (1993). The nature of the firm (1937). *WILLIANSON, OE; WINTER, SG*. https://doi.org/10.1093/oso/9780195065909.003.0002

Creswell, J. W., & Creswell, J. D. (2017). *Research design: Qualitative, quantitative, and mixed methods approaches*. Sage publications.

Davidson, P. (2017). The role of financial markets and liquidity. In *Who's Afraid of John Maynard Keynes*? (pp. 81-96). Palgrave Macmillan, Cham. https://doi.org/10.1007/978-3-319-64504-9_7

Demirgüç-Kunt, A., & Maksimovic, V. (2012). Funding growth in bank-based and market-based financial systems: evidence from firm-level data. *Journal of Financial Economics, 65*(3), 337-363. https://doi.org/10.1016/S0304-405X(02)00145-9

Dorn, N. ed., (2016). *Controlling Capital: Public and Private Regulation of Financial Markets*. Routledge. https://doi.org/10.4324/9781315672724

Elian, K. (2016). Employment Implications of Small-scale Industries in Developing Countries: Evidence from Jordan. *Science Technology and development- London-, 14*, 80-101.

Eniola, A. A. (2018). SME firm characteristics impact the choice of sources of financing in South-West Nigeria. *International Journal of Business and Globalisation, 21*(3), 44-366. http://dx.doi.org/10.1504/ijbg.2018.1001657

Gedajlovic, E., & Carney, M. (2010). Markets, hierarchies, and families: Toward a transaction cost theory of the family firm. *Entrepreneurship Theory and Practice, 34*(6), 1145-1172. https://doi.org/10.1111/j.1540-6520.2010.00418.x

Hair, J. F., Anderson, R. E., Tatham, R. L., & Black, W. C. (2019). *Multivariate Data Analysis*. In Pearson Education Ltd. https://doi.org/10.1016/j.ijpharm.2011.02.019

Hair, J. F., Black, W. C., Babin, B. J., Anderson, R. E., & Tatham, R. L. (2006). *Multivariate data analysis*. New Jersey: Prentice Hall.

Hair, J. F., Jr., Anderson, R. E., Tatham, R. L., & Black, W. C. (1998). *Multivariate Data Analysis with Readings* (5th ed.). Englewood Cliffs, NJ: Prentice Hall.

Hair, J., Black, W. C., Babin, B. J., & Anderson, R. E. (2010). *Multivariate data analysis* (7th ed.). Upper Saddle River, New Jersey: Pearson Education International.

Hair, J. F., Sarstedt, M., Ringle, C. M., & Mena, J. A. (2012). An assessment of partial least squares structural equation modeling in marketing research. *Journal of the Academy of Marketing Science*. https://doi.org/10.1007/s11747-011-0261-6

Hair, Joseph, F., Ringle, C. M., &Sarstedt, M. (2012). Partial Least Squares: The Better Approach to Structural Equation Modeling? *Long Range Planning, 45*(5-6), 312-319. https://doi.org/10.1016/j.lrp.2012.09.011

Hair, Jr., J. F., Black, W. C., Babin, B. J., Anderson, R. E., & Tatham, R. L. (2006). *Multivariate data analysis* (6th.). Upper Saddle River, NJ: Pearson-Prentice Hall.

Jegede, A. C., & Yunisa, A. S. (2019). Micro Financing and Economic Growth in Nigeria. *Lasu Journal of Accounting and Finance*, 114.

Johnson, T. (2017). *Ethics in Quantitative Finance: A Pragmatic Financial Market Theory*. Springer.

Laffont, J. J., & Martimort, D. (2009). *The theory of incentives. In The Theory of Incentives*. Princeton university press. https://doi.org/10.2307/j.ctv7h0rwr.5

Mai, T. T. H. (2011). *Role of the Government in Financial Market Theory and Reality in Vietnam*.

Nawrocki, D., & Viole, F. (2014). Behavioral finance in financial market theory, utility theory, portfolio theory, and the necessary statistics: A review. *Journal of Behavioral and Experimental Finance, 2*, 10-17. https://doi.org/10.1016/j.jbef.2014.02.005

Nazir, A., Azam, M., & Khalid, M. U. (2021). Debt financing and firm performance: empirical evidence from the Pakistan Stock Exchange. *Asian Journal of Accounting Research, 6*(3), 324-334. https://doi.org/10.1108/AJAR-03-2019-0019

Rindfleisch, A. (2019). Transaction cost theory: past, present and future. *AMS Review 10*, 1-13. https://doi.org/10.1007/s13162-019-00151-x

Vogel, H. L. (2018). *Financial Market Bubbles and Crashes: Features, Causes, and Effects*. Springer. https://doi.org/10.1007/978-3-319-71528-5

Williamson, O. E. (1990). A comparison of alternative approaches to economic organization. *Journal of Institutional and Theoretical Economics (JITE)/Zeitschrift für die gesamte Staatswissenschaft*, 61-71

Williamson, O. E. (2010). Transaction cost economics: The natural progression. *American Economic Review, 100*(3), 673-690. https://doi.org/10.1257/aer.100.3.673

Appendix A

Table 1. Results of Path Analysis

	Coefficient	std. err.	z	P>|z|	[95% conf. interval]	
Structural						
overdraft						
loan	.7093626	27.30468	0.03	0.979	-52.80683	54.22556
performance	.0716726	.603662	0.12	0.905	-1.111483	1.254828
tangible	.1418178	3.659172	0.04	0.969	-7.030027	7.313663
intangible	.3315805	3.544795	0.09	0.925	-6.61609	7.279251
policy	.1527991	6.923991	0.02	0.982	-13.41797	13.72357
_cons	.3450355	109.2192	0.00	0.997	-213.7206	214.4107
loan						
overdraft	-.171332	13.92057	-0.01	0.990	-27.45515	27.11248
bill	.6607205	72.65	0.01	0.993	-141.7307	143.0521
performance	.0452484	.3128057	0.14	0.885	-.5678395	.6583363
tangible	.1004544	11.44853	0.01	0.993	-22.33825	22.53916
intangible	.125514	14.35187	0.01	0.993	-28.00363	28.25466
policy	.1037765	27.36955	0.00	0.997	-53.53955	53.7471
_cons	-3.619892	123.3912	-0.03	0.977	-245.4623	238.2225
bill						
loan	-.4982835	69.01986	-0.01	0.994	-135.7747	134.7781
performance	.0003833	1.305186	0.00	1.000	-2.557735	2.558501
tangible	.1311723	14.86853	0.01	0.993	-29.0106	29.27295
intangible	.1209132	16.03108	0.01	0.994	-31.29942	31.54125
policy	.2043449	45.13236	0.00	0.996	-88.25345	88.66214
_cons	-4.596022	113.5274	-0.04	0.968	-227.1056	217.9136
cp						
bill	-.2262442	85.6895	-0.00	0.998	-168.1746	167.7221
performance	-.012636	.2858944	-0.04	0.965	-.5729788	.5477067
tangible	.0543746	16.2836	0.00	0.997	-31.8609	31.96965
intangible	.0804812	15.08937	0.01	0.996	-29.49414	29.6551
policy	.2210382	58.18749	0.00	0.997	-113.8243	114.2664
_cons	.6267522	76.34485	0.01	0.993	-149.0064	150.2599
debt						
cp	.8601035	97.23662	0.01	0.993	-189.7202	191.4404
performance	.0314466	.2468237	0.13	0.899	-.452319	.5152122
tangible	.0885106	6.31949	0.01	0.989	-12.29746	12.47448
intangible	.0404729	7.951736	0.01	0.996	-15.54464	15.62559
_cons	2.301202	182.7729	0.01	0.990	-355.9272	360.5296
mean(performance)	43.20468	.4737354	91.20	0.000	42.27617	44.13318

mean(tangible)	43.4269	.4735188	91.71	0.000	42.49882	44.35498
mean(intangible)	42.64035	.4768213	89.43	0.000	41.7058	43.5749
mean(policy)	26.50585	.3422613	77.44	0.000	25.83503	27.17667
var(e.overdraft)	26.68271	179.2024			.0000512	1.39e+07
var(e.loan)	22.30075	640.2324			8.15e-24	6.10e+25
var(e.bill)	24.33888	509.5714			3.67e-17	1.61e+19
var(e.cp)	10.01479	1937.661			2.0e-164	4.9e+165
var(e.debt)	15.15176	803.4784			1.10e-44	2.08e+46
var(performance)	76.75343	5.869481			66.07007	89.16426
var(tangible)	76.68325	5.864115			66.00966	89.08273
var(intangible)	77.75662	5.946197			66.93363	90.32966
var(policy)	40.06283	3.063681			34.48646	46.54089
Cov (performance, tangible)	46.51789	4.851483	9.59	0.000	37.00915	56.02662
cov(performance, intangible)	39.51806	4.692212	8.42	0.000	30.32149	48.71462
cov(performance, policy)	21.49003	3.215815	6.68	0.000	15.18715	27.79291
cov(tangible, intangible)	50.71201	4.995419	10.15	0.000	40.92117	60.50285
cov(tangible,policy)	23.5823	3.257144	7.24	0.000	17.19841	29.96618
cov(intangible,policy)	18.41877	3.178142	5.80	0.000	12.18973	24.64781
LR test of model vs. saturated: chi2(2) = 1.38					Prob > chi2 = 0.5024	