



# **FACTORS INFLUENCING ACCESS TO DEBT FINANCING AMONG SMALL AND MEDIUM AGRIBUSINESS ENTERPRISES IN BENI TOWN, DEMOCRATIC REPUBLIC OF THE CONGO**

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## **Abstract**

*The objective of this study was to examine the influence of firm-level factors on access to debt financing among Agribusiness-SMEs in Beni, DRC. The study's target population consisted of 91 employees working in the respective finance departments of the 27 small and medium-sized agribusiness enterprises operating in Beni, DRC. A self-administered questionnaire was used to collect primary data which was analysed using the Statistical Package for Social Sciences (SPSS) version 23.0. Both descriptive and inferential statistical analysis were conducted. Findings showed that firm-specific factors, financial factors, and manager/owner factors play a significant role as far as access to debt is concerned. The study indicated that the three categories of factors combined together explain 66.4% of the access to debt financing among Agribusiness-SMEs in Beni. The study recommended that Agribusiness-SMEs have proper accounting in order to increase their chances of accessing debt financing.*

*Keywords: Access to debt financing, Firm-specific factors, Financial factors, Manager/owner-specific factors*

## INTRODUCTION

Although agriculture caters for numerous needs such as food, clothing, and medicines, until relatively recently, economists approached it as a sector of economy concerned with agricultural production for subsistence purposes (Zylbersztajn, 2017). However, in recent decades the agricultural value chain has been brought to the fore. As a result, the concept of agribusiness has emerged. Today agribusiness is one of the largest industries on earth (Fleet, Fleet, & Seperich, 2014).

Bulaya (2017) defined agribusiness as organized firms devoted to commercial agriculture that involves transforming smallholders to market participants. Barnard, Akridge, Dooley, and Foltz (2014) grouped agribusiness activities into four types of industries as follows: input industries, production industries, value-added industries and support industries.

Small and medium enterprises (SMEs) operating in Agribusiness sector are deemed to have a tremendous potential for growth, job creation, and development because of the important role agriculture plays. Moreover, SMEs account for up to 60% of total employment and up to 40% of gross domestic product (GDP) in emerging economies (World Bank, 2015). There seems to be a prevalent consensus that access to finance has the potential to fundamentally boost the performance of the small and medium enterprise sector, especially in the developing countries (Mensah & Agbekpomu, 2015).

Beni is a town located in North-Kivu province in the Democratic Republic of the Congo (DRC). In 2017, the town reportedly counted over 400,000 inhabitants (Kamwira & Tshikongo, 2017). Agriculture and small trade are the main income generating activities. Beni region is endowed with rich soil where subsistence crops such as beans, cassava, maize, and rice, as well as cash crops such as cocoa, coffee and oil palm are produced. This study aims at establishing the influence of firm-level factors on access to debt financing among Agribusiness-SMEs operation in Beni, DRC.

### Statement of the Problem

Hindrances related to finance accessibility are the main challenges facing SMEs in Sub-Saharan Africa (Quartey, Turksona, Abor, & Abdul, 2017). In DRC, and in Beni town in particular, under-utilization of agribusiness potential can be attributed, among other reasons, to the too little funding in the sector. A World Bank-sponsored survey suggests only 2% of Congolese farmers and entrepreneurs have been able to borrow capital to start, operate or expand their farms or businesses in 2017 (Demirgüç-Kunt, Klapper, Singer, Ansar, & Hess, 2018).

Credit refusal rate is significantly high in DRC, especially for micro, small and medium enterprises. The credit refusal rate can be as high as 50 % (Schwarz, 2011). In some regions of

the country such as South-Kivu province, there are more rejections than approvals of loan applications (Woldie, Mwangaza, & Thomas, 2018).

Although there are several banks and microfinance institutions operating in Beni, SMEs and Agribusiness-SMEs in particular often fail to comply with the financiers' requirement. In addition, there is very little trade credit between companies. As a result, most SMEs in the region do not grow, on the contrary they tend to go bankrupt at an early stage of their existence.

## **THEORETICAL FRAMEWORK**

This research was informed by the pecking order theory and the trade-off theory.

The pecking order theory (POT) was developed on the assumption that there is a symmetry of information between internal stakeholders (owners and managers) and external funds providers of the firm (such as financial institutions) (Myers & Majluf, 1984). The POT suggests that a business leader observes following hierarchy as far as financing decision is concerned: self-financing, non-risky debt issuance, risky debt issuance and equity issuance as a last resort. Al-Tally (2014) confirmed that firms preferably finance their new investments with self-financing also referred to as internally generated funds.

In case internally generated funds are insufficient, firms resort to debt capital. Equity financing (issuance of shares) is only resorted to when both internally generated funds and debt financing are not enough. The above explanation of the POT suggests that it is expected that firms with more internally generated funds and high liquidity tend to use less debt because they are willing to use internal funds when these are available (Al-Tally, 2014). Also, the POT underscores the importance of profitability (Brealey, Myers, & Allen, 2011). Indeed, only profitable firms can afford using less debt because they generate sufficient internal capital.

The trade-off theory of capital posits that a company's optimal debt financing level is established by a trade-off between the costs and advantages of borrowing, holding the company's assets and investment plans constant (Myers, 1984). Intensive use of debt financing implies that the firm opts for paying higher interests and less tax because interests paid are tax deductible (Abeywardhana, 2017). Thus, the main advantage of debt financing is the tax deductibility of the interest payments (Clemente-Almendra & Sogorb-Mira, 2018). In contrast, intensive use of equity financing, though interest-free, results in high tax payments (Abeywardhana, 2017). Corporations will try to find debt financing levels that balance the tax advantages of additional debt against the possible bankruptcy costs often referred to as financial distress (Brealey et al., 2011; Myers, 2001). Myers' trade-off theory was useful and therefore widely accepted because it justifies why companies do not use excessive debt.

## **Access to Debt Financing**

Access to debt financing refers to the situation where there are little or no significant financial constraints to the acquisition of debt capital (Bature, Sallehuddin, & Hin, 2018). Further, Bature et al. consider access to debt financing as an important factor which firms can rely upon to improve their aptitudes to identify and take advantage of business opportunities and deliver value in the marketplace. According to Arora (2014), access to finance, including debt financing, break financing constraints that can stop businesses from expanding. The access to debt financing can be measured by the number of times an enterprise has been able to borrow (Nanyondo, Tauringana, Kamukama, & Nkundabanyanga, 2014), and the size of the loan it has obtained (Zarook, Rahman, & Khanam, 2013).

## **Factors Influencing Access to Debt Financing**

Factors that determine the access to debt financing by agribusiness small-scale enterprises are similar to those in the mainstream small business sector (Mensah & Agbekpomu, 2015). These factors are either firm-specific, financial or manager/entrepreneur specific.

## **Firm-specific Factors that Influence Access to Debt Financing**

The size, age and location of an enterprise have been identified as significant variables that influence its access to external sources of finance.

Smaller businesses have less access to debt financing than bigger ones (Kira & He, 2012). This phenomenon might be explained by the following various reasons. First, smaller enterprises are considered as the riskiest. As a result, lenders refrain from granting credit to small businesses. A worldwide survey on firm size and business environment concluded that there is a negative relationship between firm size and risk level. In other word, the smaller the firm, the riskier it is (Schiffer & Weder, 2002). In addition, when smaller firms are granted credits, the debt maturity is often shorter (Berger & Udell, 1998).

Secondly, smaller enterprises struggle to maintain a reliable bookkeeping. In 1998, Berger and Udell suggested that smaller firms do not have audited financial statements, making it extremely difficult to impose ratio-related financial covenants that typically accompany intermediate and long-term bank debt.

Thirdly, smaller businesses most likely cannot afford collateral requirements. Berger and Udell (2002) concluded that smaller and younger firms are more likely to incur higher cost of financing and at the same time they are required to offer collateral. Small firms do not have a strong collateral basis (Berger & Udell, 1998). As a consequence, any financial innovations that

reduce the need for collateral ease credit constraints on small firms more than large ones (Beck, Demirguc-Kunt, Laeven, & Levine, 2008).

The simplest way to look at the firm age is to count the number of years of formation (Ezeoha & Botha, 2012). Firm age in years is often used to control for the fact that older firm may have more experiences of applying for loans and have deeply long relationship with lenders and therefore more probability to get loans (Le, 2012).

Younger firms are the most exposed to problems as far as accessing debt financing is concerned (Kira, 2015). The main reason why newly created firms cannot easily access debt financing is that they lack supportive information on both their credit worthiness and performance. Therefore, because of the information asymmetry and the moral hazard that stems from it, lenders tend to shy away from start-up businesses. Moreover, as a firm secures a credit reputation, moral hazard reduces hence a path to access debt finance is created (Kira & He, 2012).

Location is another firm's factor that can influence its ability to access external finance and debt financing in particular. The closeness to financial services providers tends to be positively correlated with access to debt financing. Kira and He (2012) concluded that the closer the firm, the higher the debt ratio. Pandula (2011) pointed out that location has influence on both the cost and availability of finance, especially for small firms. The author brought at the fore various factors that contribute to spatial variations in the availability of finance for small firms in remote areas. Primarily, there is a high likelihood for firms operating in rural areas to face the absence of financial institutions. Very often, there are too few financial institutions in rural areas. As a result, most small and medium enterprises end up paying exorbitant interest on loans due to lack of alternatives.

Also, Pandula (2011) brought forward the fact that the bank branch managers assigned in rural areas may have limited delegation of authority. This situation is likely to cause either delays in approving loans requested by firms in rural areas or high amount of loan rejections, as the loan approval and processing are done by the head office officials who seldom have accurate knowledge of customers and their business projects.

### **Financial Factors that Influence Access to Debt Financing**

Firm financial characteristics such as performance, collateral base and quality of financial reporting can influence the ability of an enterprise to access debt financing.

It is often argued that SME sector faces difficulties to access external finances for their investment projects because of lack of assets to be pledged as collateral (Kira & He, 2012). Collateral can be used to curb the information asymmetry problem posed by debt financing.

Indeed, lower risk borrowers are willing to pledge more and better collateral, given that their lower risk means they are less likely to lose it (Jiménez & Saurina, 2004). Thus, collateral acts as a signal enabling the lender to mitigate or eliminate the adverse selection problem caused by the existence of information asymmetries between the bank and the borrower at the time of the loan decision.

Financial performance indicators such as turnover and profitability can influence a firm's debt financing level in particular. Serghiescua and Vaidean (2014) found that as far as capital structure is concerned, there is a pecking order according to which a profitable enterprise with a high level of liquidity will have a reduced level of debt. Moreover, empirical evidences suggest that there is a relationship between a firm's performance and its access to credit (Lourenço & Oliveira, 2017).

Often, lenders and financial institutions in particular require sound financial information before they process applications for credit. Kung'u, Claude, and Mang'oka (2016) argued that audited financial statements improve borrower's credibility and therefore reduce risk for lenders. For financial institutions, the decision to lend and the terms of the loan contract are principally based on the strength of the balance sheet and income statements (Berger & Udell, 2002). In another study, Berger and Udell (1998) noted that many of the small-scale businesses do not have audited financial statements that can be shared with any provider of outside finance. As a result, small-scale enterprises find it difficult to access debt financing.

### **Manager/Owner Factors that Influence Access to debt Financing**

Factors such as manager/owner education, skills, and awareness of financing opportunities are deemed to have influence on the ability of a firm to access credit (Gichuki, Njeru, & Tirimba, 2014; Osano & Languitone, 2016). Management experience and education level are a very important factor in allowing owners/ managers of SMEs to obtain access to finance (Zarook et al., 2013). In fact, the higher level of education of SMEs' owners/managers has, the better is their access to finance. According to the Underhill Corporate Solutions (UCS, 2011), the higher the level of managerial competency shown by the owners of a business enterprises, the more effective they are likely to be in accessing debt financing. Manager's gender has also been mentioned as a factor that can influence the capital structure of a firm (Barno, 2017). Indeed, Barno (2017) concluded that there is a negative and significant relationship between the gender of the managers and capital structure. Females managers tend to be can be more likely to hold less risky capital.

## METHODOLOGY

The study adopted a cross-sectional descriptive survey and used a structured questionnaire to collect primary data. In this study, a purposive sampling technique was adopted. The target population being relatively small, the researcher resorted to a census approach whereby all the staff working in the respective finance departments of the 27 Agribusiness-SMEs was considered for the study. Therefore, the researchers targeted, 91 finance managers of all the 27 small and medium-sized agribusiness enterprises operating in Beni as of 5 February 2019.

Statistical Package for Social Sciences (SPSS) version 23.0 was resorted for data analysis. The researchers pretested the questionnaire to make sure it lived up to his expectations. For that purpose, 10 respondents (representing over 10% of the target population) were considered. The validation of the questionnaire was achieved through validity and reliability tests. The content validity was achieved by closely examining the questionnaire to check the relevance of the questions in terms of their objectivity, meaning and clarity. This study used Cronbach's alpha coefficients to determine the reliability of the research instrument. Admittedly, the questionnaire is reliable if the Cronbach's alpha value is greater than or equal to 0.7 (Bryman & Bell, 2011).

Table 1: Reliability Statistics

Category of multiple Likert scale items	Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	No. of Items
Firm-specific factors	.916	.916	11
Financial factors	.869	.871	11
Manager/owner factors	.840	.843	5
Access to debt financing	.797	.798	7

The Cronbach analysis findings shown in Table 1 indicate that Cronbach's alpha coefficients for all variables with multiple Likert scale items was above 0.7, an indication that the level of internal consistency for the items that were used in each variable was acceptable hence the items were reliable to measure variables and achieve the objectives of this study.

## ANALYSIS AND FINDINGS

Both descriptive and inferential statistical analysis were conducted. All the interpretations were based on a threshold of 5% significance level. The analytical model adopted was:

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \epsilon$$

Where, Y = Access to debt financing,  $\beta_0$  = Regression constant,  $\beta_1$  = Coefficient of firm-specific factors,  $\beta_2$  = Coefficient of financial factors,  $\beta_3$  = Coefficient of manager/owner factors,

X1 to X3 = Independent variables (firm-specific factors, financial factors, manager/owner factors) and  $\varepsilon$  = Error term.

### Study Response Rate

91 questionnaires were administered, out of which 89 were properly filled and returned leading to a response rate of 97.8% of the sample size.

### Profile of Agribusiness SMEs

The 27 SMEs that were surveyed were grouped into five sectors: farming, distribution, processing and final consumption. Frequencies and percentages were examined.

Table 2: Distribution per Sector

Sector	Frequency	Percentage (%)
Farming	2	7
Distribution	8	30
Processing	8	30
Final consumption	9	33
Total	27	100

### Influence of Firm-specific, Financial and Manager/owner-specific factors on Access to Debt Financing among Agribusiness SMEs

The objective of this study was to establish the effects of firm-specific, financial and manager/owner factors on access to debt financing among Agribusiness-SMEs in Beni. Table 3 shows the correlation coefficients between the study variables.

Table 3: Correlation Matrix for all Variables

		Access to debt financing	Firm-specific factors	Financial factors	Manager/owner-specific factors
Access to debt financing	Pearson Correlation	1			
	Sig. (2-tailed)				
Firm-specific factors	Pearson Correlation	.674**	1		
	Sig. (2-tailed)	.000			
Financial factors	Pearson Correlation	.776**	.656**	1	
	Sig. (2-tailed)	.000	.000		



Manager/owner-specific factors	Pearson Correlation	.722**	.668**	.729**	1	Table 3...
	Sig. (2-tailed)	.000	.000	.000		

\*\*Correlation is significant at the 0.01 level (2-tailed).

Results from the correlation matrix shown in Table 3 reveal a relatively strong positive correlation between access to debt financing and each of the firm-level factors. The correlation coefficients between access to debt financing and firm-specific factors, financial factors, and manager/owner factors were 0.674, 0.776 and 0.722 respectively. Further, these correlation coefficients turned out to be statistically significant ( $p < 0.05$ ).

Regression analysis was conducted in order to ascertain the extent to which changes in firm-specific, financial and manager/owner-specific factors explained by the change in access to debt financing by small and medium agribusiness enterprises.

### Test of Regression Assumptions

Several tests were conducted on the data set before a regression analysis was carried out. The test for multivariate normality using normal probability plots was conducted. The results were suggestive of a normal distribution as illustrated on figures 1, 2 and 3. Indeed, the visual presentation indicates that the observed values deviated reasonably from the expected values apart from a few items.

Figure 1: Normal Probability P-P Plots for Firm-specific factors

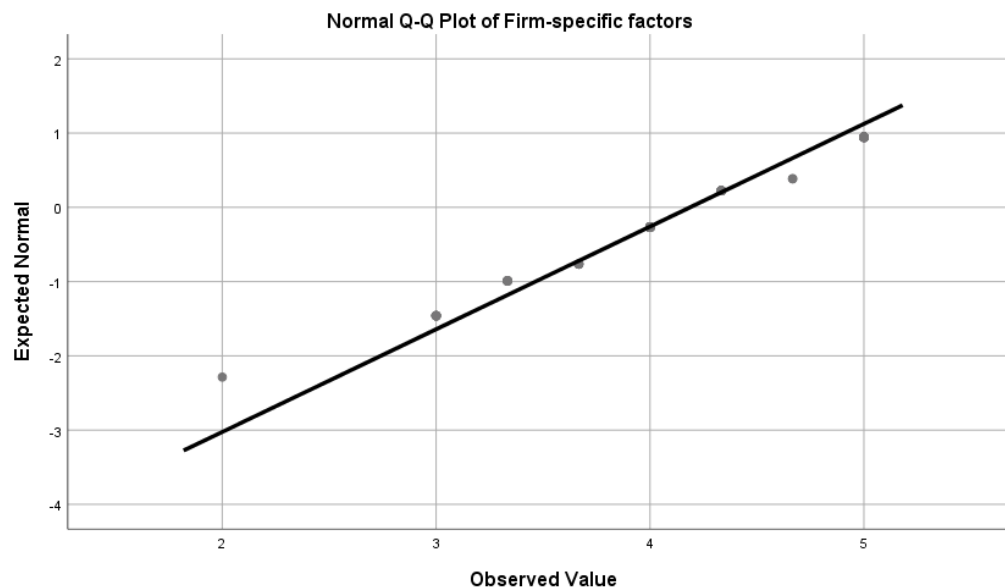


Figure 2: Normal Probability P-P Plots for Financial factors

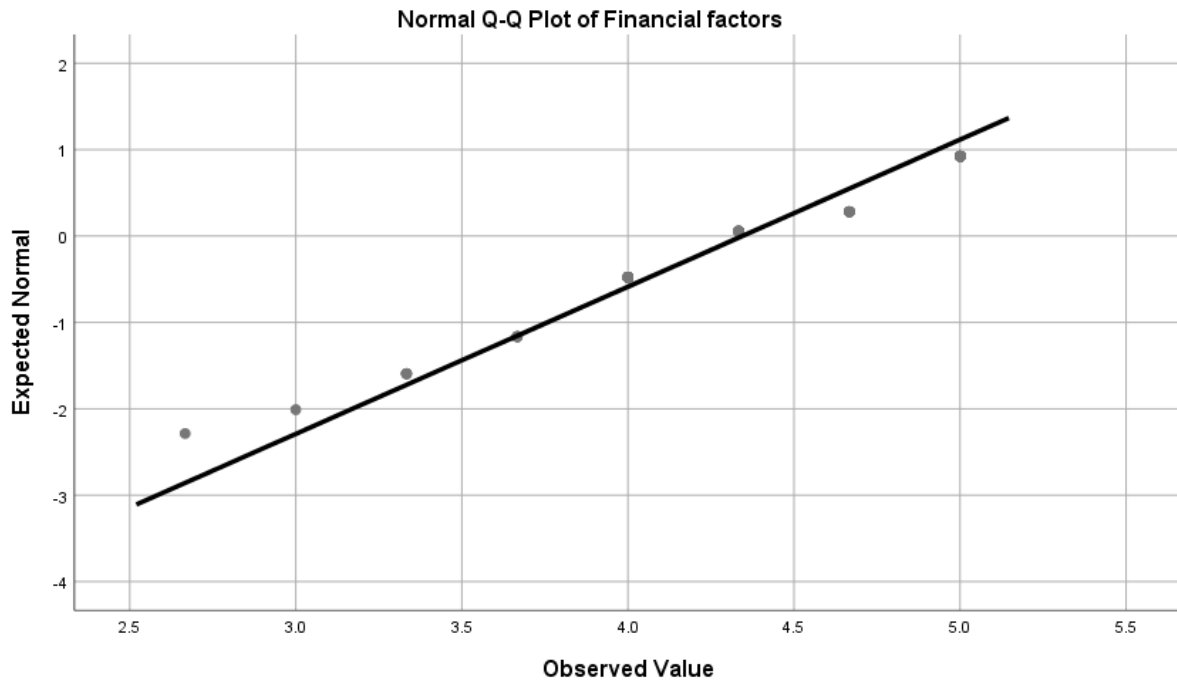
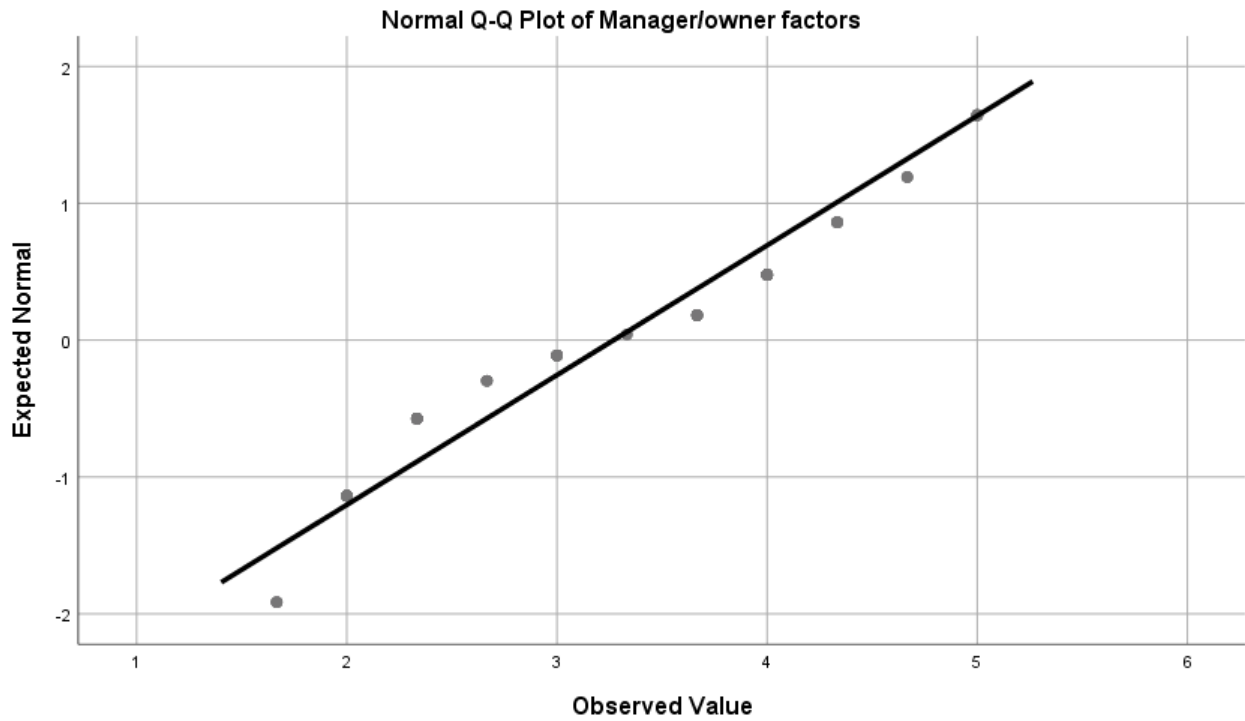


Figure 3: Normal Probability P-P Plots for Manager/Owner-specific factors



Moreover, the researchers computed the variance inflation factor (VIF) to test for multicollinearity. A VIF greater than 10 is considered unsatisfactory, indicating that the independent variable should be removed from the analysis (Lind, Marchal, & Wathen, 2018).

Table 4: Tolerance and VIF Values

Model	Collinearity Statistics	
	Tolerance	VIF
1 Firm-specific factors	.493	2.028
2 Financial factors	.417	2.396
3 Manager/owner factors	.405	2.468

Table 4 indicate that VIFs were 2.028, 3.396 and 2.468 for firm-specific factors, financial factors, and manager/owner factors respectively. Given that all the VIFs are less than 10, it can be concluded that the independent variables are not strongly correlated with each other.

The researcher also tested for the homoscedasticity of the data set. According to Saunders, Lewis, and Thornhill (2016) homoscedasticity is the extent to which the data values for the dependent and independent variables have equal variances. Levene test for homogeneity is often used to assure there is no heteroscedasticity (Hair, Black, Babin, & Anderson, 2014). For this study the Levene statistics were as follows.

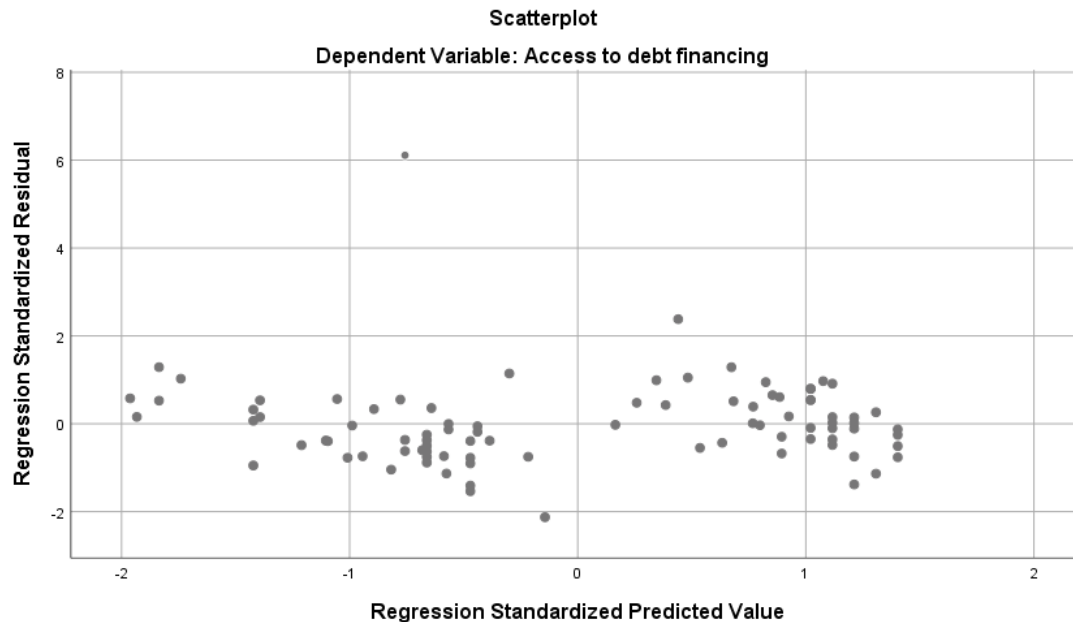
Table 5: Test of Homogeneity of Variance

Predictor variable	Levene statistics	Sig.
Firm-specific factors	3.790	.000
Financial factors	4.346	.000
Manager/owner factors	1.931	.000

As shown in Table 5, the Levine's test for homoscedasticity was significant for all the predictor variables (Firm-specific factors: .2.790,  $p < 0.05$ ; Financial factors: 4.346,  $p < 0.05$ ; Manager/owner factors: 1.931,  $p < 0.05$ ). Thus, the assumption of homogeneity of variance is met.

Finally, Linearity was tested through residual plots generated by SPSS. A scatter plot of standardized residuals (ZRESID) against standardized predicted (ZPRED) values was used as suggested by Kyongo (2016). The graph suggested that the linearity assumption was met, since data point are spread almost evenly above and below the zero on the X axis.

Figure 3: Scatter Plot of ZRESID against ZPRED



Based on the abovementioned tests, it was concluded that a regression analysis was appropriate. Table 5 shows the Model Summary of the multiple regression analysis that was conducted using firm-specific factors, financial factors and manager/owner factors as independent variable; while access to debt financing was the dependent variable.

Table 5: Model Summary of the Regression Analysis

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.822 <sup>a</sup>	.675	.664	.43731	.675	58.979	3	85	.000

a. Predictors: (Constant): Firm-specific factors, financial factors, manager/owner factors

Findings in Table 5 indicate that the three independent variables (Firm-specific factors, financial factors, manager/owner factors) explain only 66.4% (Adjusted  $R^2=0.664$ ) of the dependent variable (access to debt financing). This therefore means that other determinants, not considered in this research, influence access to debt financing at 33.6%. Therefore, further research needs to be carried out to establish these other determinants of access to debt financing among Agribusiness-SMEs in Beni City, DRC.

Further, the researchers tested if the overall model summarized in Table 5 is valid. Table 6 shows a summary of the ANOVA statistics obtained from the mean of the three types of firm-level factors (firm-specific, financial, manager/owner) that influence access of debt financing among Agribusiness-SMEs in Beni.

Table 6 ANOVA of the Regression

ANOVA <sup>a</sup>					
Model	Sum of Squares	Df	Mean Square	F	Sig.
Regression	33.838	3	11.279	58.979	.000 <sup>b</sup>
Residual	16.256	85	.191		
Total	50.093	88			

a. Dependent variable: Access to debt financing among Agribusiness-SMEs

b. Predictors: (Constant): Firm-specific factors, financial factors, manager/owner factors

The significance value for the relationship between firm level factors and access to debt financing among Agribusiness-SMEs is 0.000. Since the statistical significance p - value is less than 0.05 ( $p < 0.05$ ), it can be concluded that the relationship between the firm-level factors and Access to debt financing among Agribusiness-SMEs is statistically significant. The coefficients of regression are summarized in table 7 as follows:

Table 7: Regression of Coefficients for Firm-level Factors on Access to Debt Financing among Agribusiness-SMEs

Model	Un-standardized		Standardized	T	Sig.
	Coefficients <sup>a</sup>		Coefficients		
	B	Std. Error	Beta		
(Constant)	-.365	.401		-0.910	0.365
2 Firm-specific factors	.215	.092	.206	2.345	.021
3 Financial factors	.591	.123	.460	4.809	.000
4 Manager/owner factors	.178	.069	.248	2.560	.012

a. *Dependent variable: Access to debt financing among Agribusiness-SMEs*

The findings in Table 7 indicate that at 5% level of statistical significance and 95% level of confidence, the relationships between firm-level factors (firm-specific, financial, and manager/owner) and access to debt financing among Agribusiness-SMEs were all significant

since the significance values ( $p$ ) are less than 0.05 ( $p \leq 0.05$ ) for all the factors. These results imply that the relationship between each category of the firm-level factors accessibility to debt financing among Agribusiness-SMEs in Beni was statistically significant.

## DISCUSSION

These findings are consistent with Kira and He (2012) who observed that size and age of an enterprise are key determinants of access to external sources of finance. Kira and He (2012) noted that smaller and younger businesses have less access to debt financing than bigger ones because they lack supportive information on both their credit worthiness and performance.

These results are also in line with Ezeoha and Botha (2012) who found that a sound asset basis guarantees a greater access to long-term debt financing in South-Africa. Karanja, Wachira, and Lyria (2015) demonstrated that meeting collateral requirement has a major positive significant contribution on access to debt financing in Kenya. Kira (2015) argued that collateral is an important factor for any firm to gain access to debt from lenders. Therefore, he advised SMEs owners to improve their investment on tangible assets.

Further, the findings are consistent with Laurengo and Oliveira (2017) who ascertained that the financial performance influences debt financing among Portuguese enterprises. Furthermore, the findings are consistent with Zarook et al. (2013) who found that business management experience is an important factor in allowing owners/ managers of SMEs to obtain access to finance.

Finally, the findings are consistent with Thuku (2017) who established that firm characteristics, financial characteristics and entrepreneur characteristics have a significant effect on access to finance among agriculture-sector SMEs in Nyeri County, Kenya. The findings also imply that there exist other factors that explain the 33.6% of access to debt financing. These factors may include the macro-economic factors like interest rate and inflation rates (Saghir & Aston, 2018; Nyamita, Garbharran, & Dorasamy, 2014).

## CONCLUSION

The findings indicated that at 95% level of confidence, the relationships between firm-specific, financial, and manager/owner factors and access to debt financing among Agribusiness-SMEs were all significant. Moreover, findings showed that when combined, enterprise-level factors (firm-specific, financial, manager/owner) explain only 66.4% (Adjusted  $R^2=0.664$ ) of the access to debt financing among Agribusiness-SMEs in Beni.

Another study should be conducted to establish the other factors that are responsible for the remaining 33.6% effect on access to financing. In addition, the study recommends further investigations approaching the same problem from the financial institutions' point of view.

The study recommended that Agribusiness-SMEs must have proper accounting records in order to increase their chances of accessing debt financing. To the managers/owners of Agribusiness-SMEs acquiring necessary skills/tools would boost their competitiveness. It was also recommended that financial institutions should develop products that suit Agribusiness-SMEs characteristics such as age, size and location and make funding mechanisms simpler and more responsive to their needs. Further, it is recommended that collateral requirements should be commensurate with loans size in order to allow small businesses with relatively fewer assets to afford access to debt financing. Finally, this study recommends the DRC government to support the cost of inputs and climate change issues since Agribusiness finance can play an important role in eradicating extreme poverty in the country.

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