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CHAPTER ONE

INTRODUCTION

1.1 Background of Study

The term capital structure is used to represent theproportionate relationship between debt and equity. Equity includes paid-upshare capital, share premium and reserve and surplus (retained earnings)(Pandey, 2010), while debt can be classified into bank debt, straight bonddebt, convertible bond debt, program debt (such as commercial paper), mortgagedebt, and all other debts (Rauh & Sufi, 2008). A firm can issue a largeamount of debt or a large amount of equity; hence it is important for a firm todeploy the appropriate mix of debt and equity that can maximize its overallmarket value. Utilization of different levels of equity and debt by managers isone strategy used by firms to improve their financial performance (Gleason, Mathur& Mathur, 2000).

Capital structure is important for agricultural firms,lenders, and policy analysts because all of them need information aboutfinancial structure of agricultural enterprises in order to make justifieddecisions about farm viability (Nurmet, 2011). It is the most significantaspect of company's operations. Capital structure theories predict thatleverage level influences a firm's performance (Orua, 2009). Maina and Ishmail(2014) reported that there was evidence of a negative and significantrelationship between capital structure and all measures of performance. Thisimplies that the more debt the firms used as a source of finance theyexperienced low performance. Capital structure decision is a vital decisionwith great implications for the firm's sustainability. The ability of theorganization to meet its stakeholders need is closely related to the capitalstructure (Leon, 2013).

Agricultural credit is the present and temporary transfer ofpurchasing power from a person who owns it to a person who wants it, allowingthe later opportunity to command another person's capital for agriculturalpurposes, but with confidence in his willingness and ability to repay at aspecified future date with or without interest (Nwaru, 2011). According to Akudugu(2012), credit is a strategic empowerment tool that has the potential to changethe life of a person, family or community from a situation of abject poverty toa more dignified life. It can transform self-image, unlock potential and boostthe productivity and well-being of the poor and vulnerable. Credit could bringabout higher productivity and profit in agricultural production (Ashaolu,Mamioh, Philip & Tijani,2011) and may be financial or consist of goods andservices.

Access to agricultural credit has been positively linked toagricultural productivity in several studies in Nigeria (Rahaman & Marcus2004; Abu, Odoemenem,& Ocholi, 2010; Ugbajah, 2011), higher credit levelsare associated with higher input use (Satyasai, 2012). Access to credit bysmall and medium agro enterprises is vital because the contributions whichsmall and medium scale enterprises (SMEs) make to the economic growth processhave been well documented (Mambula, 2002). Small and medium scale enterprises(SMEs) generate more direct job per naira of investment than do largerenterprises. They serve as a training ground for developing technical andentrepreneurial skills and; by virtue of their greater use of indigenoustechnological capabilities, they promote local inter-sectoral linkages andcontribute to the dynamism and competitiveness of the economy. Prior to the1970s, the small and medium scale enterprises (SMEs) belonged to the past butthis view has since changed because the contributions of SMEs to industrial andeconomic growth of countries have been recognised internationally (Nnanna,2001). SMEs access to

credit therefore will play an important role in enhancingeconomic recovery. The extent to which firms can access external financing hasbeen shown to have an influence on the investment activity of the firm and theability of the firm to trade internationally (McCann, 2001). Unfortunately,SMEs, the engine of economic growth and development in many developingeconomies are still a shadow of themselves (McCann, 2001). Ihyembe (2000), Eze (2007), Ike and Chidebelu (2003),attributed several reasons for the poor performance of agro-based SMEs. Amongthese is that they are operating under an environment of poor credit policysupport which does not provide opportunity for maximization of profit in acompetitive market. Ihyembe (2000) also reported that the absence of capitalcould frustrate the taking off of any business and since personal savings orcontributions from family members and peer groups were not always enough, providingbank credit to SMEs would enable the SMEs provide necessary capacity building,infrastructure and raw materials to large scale industries. Due to diversefinancial as well as non-financial and behavioural factors, small and mediumscale enterprises rely more heavily on short term funding and this makes themmore prone to volatile economic situations. Under such circumstances, bankshave to request for more reliable collateral security to guard against loandefault.

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