Financial Mobilization Methods and Small Bakeries Operations in Lagos Metropolis: A Pecking Order Theoryperspective

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Abstract
Access to adequate financial resources is paramount for SMEs to establish and sustain operations effectively. Hence, this study presents a theoretical review of the financial mobilization methods of small bakeriesoperations in Lagos metropolis according to the Pecking Order Theory (POT). The Pecking Order Theoryassumes that firms prioritize their sources of finances based on the principle of least effort or resistance. A question was raised to guide the study and a desk review of relevant extant literature methodology was employed. Thus, the study presents the financial mobilization methods under two broad concepts as commonly done in financial studies. These are the internal and external sources of finance. The external source is further classified into debt and equity financing. The pecking order theory is expatiated with its assumptions, benefits and limitations. Subsequently, the theoretical implications of the financial mobilization methods are discussed. The findings suggest that while internal financing through retained earnings enhances financial stability and growth, strategic external financing decisions can also influence the operations of small bakeries under certain conditions. The implication of the findingis that bakeries can strengthen their financial operations prospects by prioritising efficient management of retained earnings and carefully considering external financing options. It is, therefore, suggested that when external financing is necessary, bakeries should carefully consider debt options to minimize costs and avoid excessive leverage, aligning with the preferences of the Pecking Order Theory.
Keywords: External financing, Equity Issuance, Financial Resources, Pecking Order Theory, Small Sizedbakeries

Introduction

Access to finance for small and medium enterprises (SMEs) has always been an issue for debate within the circles of economists and researchers. The ability to gain adequate access to financial capital enables SMEs to establish and subsequently operate effectively (Mnuka and Oyagi, 2021). This is especially true for small bakeries in Lagos who have been experiencing consistent hike in the price of baking items which have continued to trigger the cost of bread in recent times. The capital structure and financial mobilization strategy of SMS bakeries therefore have important implications for their performance (Anastasia, Anthony & Benedict, 2020).

Financing mobilization decision in selecting one or more sources of finance mainly depends on available financial sources in the financial system, preferences of owners and accessibility to finance. This decision is one of a vital decision for any firm regardless of the size, industry, etc. This is because business has a direct relationship with firm finance and its effect on ability of taking competitive advantage (Heng and Azrabijani, 2012). As a result, financing decisions are imperative for Small and Medium Enterprises (SMEs) similar to large enterprises as SMEs function as the backbone of any country (Ahmad, 2018) specially a developing country like Nigeria. In this study, SMEs refer specifically to bakeries with 10-49 employees and/or an annual turnover of **N5** million to **N100** million, based on the Nigeria classification for small and medium enterprises. SMEs are crucial in the economy because of their provision of readymade food that can be consumed at any time of the day. Given the current inflationary trends in Nigeria, the role of these businesses becomes even more significant as they contribute to food security and affordable consumption options.

Financial resources are crucial for enhancing the performance of SMEs as they enable these businesses to invest in growth opportunities, manage operational expenses, and innovate(Smith & Green, 2020).However, many SMEs often face financial instability due to their preferences for financial mobilization. SMEs often overlook retained earnings and other internal source as a source of funding; instead, they tend to rely heavily on external finances, such as loans and equity financing, especially when seeking to expand operations or cover expenses (Doe & Lee, 2021). This reliance on external funding can lead to higher debt levels and increased financial risk, potentially compromising the business's long-term sustainability. The Pecking Order Theory provides a framework for understanding these financial decisions, positing that firms should prefer internal financing first, then debt, and finally equity, due to the costs associated with each source. By adhering to this hierarchy, SMEs can minimize costs and risks, ensuring better financial health and performance.

Financial institutions have recognized the importance of SMEs and have developed various funding options to meet their specific needs (Birškytė&Mingelaite, 2021). These options include loans, grants, and equity investments, providing the capital required for equipment procurement, hiring skilled personnel, and investing in technology to stay competitive (Kpentey, 2019; Lobanov, 2021). Recently, the rise of financial technology has created new opportunities for SMEs especially bakery firms in the financial sector (Annisa, 2015). Online lending platforms, crowdfunding, and peer-to-peer lending offer alternative sources of capital that are more accessible and flexible. These innovations have allowed SMEs to explore creative financing methods tailored to their unique needs. However, securing financial funding for SMEs remains challenging (Mirzoev&Sobirzoda, 2019). Lending institutions often evaluate the creditworthiness of these businesses, which can be difficult for those with limited financial history or collateral (Ndala, 2019). Additionally, economic fluctuations and market uncertainties can affect the availability of funds for SMEs.

Explaining the varied relationships, it is noted that some Small bakeries in Nigeria may rely on a single source of finance, while others utilize three or four different source. Similarly, Watson (2006) emphasized that the lower levels of external funding in SMEs often result from the personal choices of owner-managers, which can change, based on the owner's characteristics, firm characteristics, and external factors (Michaelas, Chittenden &Poutziouris, 1999). These indicate that SME owners have preferences for certain types of financing over others, sometimes avoiding particular sources entirely. This suggests that the financing methods of small bakeries owners can significantly influence the capital structure composition of their businesses (Osei-Assibey, Bokpin&Twerefou, 2012) as expounded by the pecking order theory.

The Pecking Order Theory identifies the SME capital structure even though it was developed for large corporations (Osei-Assibey, Bokpin, &Twerefou, 2011) but can be employed by small businesses. As outlined by Myers (1984), the theory suggested that firms adhere to a hierarchy of financing preferences, where internal finance is preferred, and if external finance is required, debt is preferred over equity. The inability of small firms to raise all the funding they would like from financial institutions has been highlighted (Hamilton and Fox, 1998), resulting in a persistent gap between the supply and demand for funding. Supporting this argument, Daskalakis, Jarvis and Schizas (2013) emphasized the importance of identifying the preferences or demands of SME owners' financing needs, as owner preferences in SMEs play a major role and there is no separation of ownership and control (Michaelas, Chittenden &Poutziouris, 1998). Again, Patel et al. (2022) found that SMEs that utilize digital payment systems and mobile money services have increased transaction efficiency and reduced transaction cost. However, bank lending is the most common source of external finance for many SMEs and entrepreneurs, but can be challenging for newer businesses (OECD, 2020).

A significant amount of research has focused on the pecking order theory, with numerous studies testing the model proposed by Shyam-Sunder and Myers (1999) across different markets and time periods. For instance, study such as Kumar et al (2020) are about the financial struggles faced by small-sized bakeries in developing countries, highlighting challenges like lack of collateral, high interest rates, and stringent loan conditions. Similarly, a study in the Wennberg et al., (2018) is about the reliance of small businesses in the United States on personal savings and credit cards, which are often expensive and risky. While Ahmed et al (2020) discusses alternative financing methods such as crowdfunding, invoice financing, and peer-to-peer lending, few studies have explored how these methods are utilized by small-sized bakeries, particularly in the Nigeria context.

Most research has analyzed a wide range of firms without specifically isolating those without debt constraints. None of these studies considered the financial mobilization methods using theoretical perspective. Therefore, there exists a gap that this study stands to fill. In view of this backdrop, the aim of this study isto examine the financial mobilization methods of small and medium sized bakeries in Lagos with the pecking order theory perspective. In achieving this aim, this research question was raised to guide the study:

What internal financial mobilization methods are available for small bakeries financialoperations?

The study is structured into the following section: Methodology, Literature Review, Conclusion, Suggestions and Implications.

Methodology

This study utilized a desk review approach to examine the financial resources mobilization methods of small and medium-sized bakeries enterprises through the lens of the Pecking Order Theory (POT). The methodology involved an extensive literature review (see appendix), gathering information from academic journals, books, reports, and reputable online sources.

Literature Review

This study literature review is subdivided into two main sections: Conceptual review and Theoretical review. The review aims to provide a comprehensive understanding of the existing knowledge and theoretical foundations that guide this study investigation into the financial mobilization methods of small and medium-sized bakeries in Lagos metropolis.

Theoretical Review

This section delves into the theoretical foundations and applications of the Pecking Order Theory, with a specific focus on small and medium sized enterprises (SMEs).

Pecking Order Theory

The Pecking Order Theory explains how firms prioritise their financing decisions to minimise costs and risks associated with funding. It suggests that firms follow a specific hierarchy when choosing their sources of capital, starting with internal funds, then debt and finally equity.Initially introduced by Donaldson in 1961 and later refined by Myers and Majluf in 1984. It proposes a hierarchy in financing strategies based on the level of information asymmetry between managers and investors. To reduce borrowing costs, firms should choose capital sources with the least information asymmetry. Typically, this means prioritizing internal funds over external ones, and within external financing, preferring debt over equity. The pecking order theory arises from the concept of asymmetric information (CFO Team, 2021) Asymmetric information, also known as information failure, occurs when one party possesses more (better) information than another party, which causes an imbalance in transaction power.

The Pecking Order Theory acts as a guiding principle for determining the hierarchy of financial sources that companies prefer when raising capital. It is applicable in various scenarios and can help pinpoint the most suitable financing source based on an enterprise profile, the nature of the investment, and market conditions. Firms follow a hierarchy when making decisions about their financial mobilization and capital structure as elucidated by Jain and Capeterra (2022).

Assumptions and Benefits

The following assumptions according to the pecking order theory are (Myers, 1984):

- The theory assumes there is no business risk.
- There are no agency costs.
- It assumes there are no taxes.
- Investment decisions are not influenced by financing decisions.
- There exists the presence of asymmetric information between managers and investors.

The Pecking Order Theory helps businesses structure their capital and manage financial risk effectively. It emphasizes cost efficiency, minimizes information asymmetry, controls ownership dilution, and mitigates business risk. The choice of financing source depends greatly on the company's profile, the nature of the investment, and market conditions.

Limitations

However, the pecking order theory also has some limitations (Ross, Westerfield, & Jaffe,2004):

- Oversimplifies complex decisions – A rigid hierarchy fails to capture real-world factors that affect capital structure.
- Ignores benefits of equity – Firms may issue equity to strategically align with investors or when shares are overvalued.
- Static view – Changing market conditions affect the relative costs of debt and equity over time.
- Using internal funds may disturb the dividend pattern of a company. Many equity investors like dividend reliability, and if the pecking order theory is applied blindly it might mean lower dividends – leading to lower share price and damaging the share price.

Conceptual Review

This section of the literature review provides a comprehensive analysis of the key concepts related to financial mobilization methods.

Financial Mobilization Methods

Financial mobilization refers to the process of gathering and managing financial resources to achieve specific goals or objectives. There are two main types of financial mobilization: internal financial mobilization and external financial mobilization.

1. Internal Source of Finance

This is the least costly and most favored source of funds, representing the profits that a company retains instead of distributing as dividends.

i. **The SME owner' savings, family, and friends:** This category involves raising funds from personal savings and from personal connections. Often referred to as "bootstrap funding," (Winborg and Landstrom, 2001), this approach leverages the entrepreneur's own financial resources, along with contributions from close relatives and friends who are personally invested in the SME owner's success. These investors may be willing to accept lower returns on their investment due to non-financial motivations such as emotional support, personal relationships, or a belief in the business's potential. While this source of funding can provide initial capital and create a supportive network, it is often limited in scale compared to more formal sources of finance. (Nduka, 2017).

ii. **Gifts and Inheritance:** Gifts and inheritance refer to the transfer of assets, property, or money from one individual to another without a reciprocal exchange or payment (Owasanoye, 2013). Gifts are voluntarily given during the giver's lifetime and can include items such as money, real estate, or personal property. Inheritance, on the other hand, occurs upon the death of the asset holder, where the deceased's estate is distributed to heirs or beneficiaries according to a will or, in the absence of a will, by the laws of intestacy (Adeogun, 2015). Both forms internal sources for a bakery owner.

iii. **Retained Profits:** Retained profits, also known as retained earnings, are the profits that a business retains for future use rather than distributing them to shareholders as dividends (Hill, 2017). This source of funding allows businesses to reinvest their profits in the company, providing a vital source of capital for growth and development. Retained profits can be used to finance various business activities, such as expanding operations, investing in new projects, or paying off debt (Berk, 2017).

iv. **Sales of Assets**: The sales of assets involve the disposal of a company's assets, such as property, equipment, or investments, to generate funds (Bruns, 2017). This source of funding can provide a quick influx of capital, which can be used to meet financial obligations, invest in new opportunities, or restructure the business. However, the sale of assets may also result in a loss of productive capacity and a reduction in the company's asset base (Kieso, 2017).

2. External Source of Finance (Debt)

After retained earnings, companies prefer debt, such as issuing bonds or taking out loans. Although debt incurs interest costs, it is generally more accessible and cost-effective than equity issuance. Additionally, debt offers tax advantages since interest payments are deductible from company profits before taxes.

i. **Trade credit:** This type of external source of finance of SMEs involves short-term credit from suppliers, is another funding option for SMEs. However, suppliers may view SMEs as risky, limiting the availability of this funding source (Summerfield, 2013).

ii. **Factoring and invoice discounting**: Factoring and invoice discounting involve raising finance against outstanding receivables (Burkart&Ellingsen, 2004). These options are suitable for short-term needs and can grow with the business as receivables increase (Wagner, 2013).

iii. **Leasing**: Leasing is a funding option that allows SMEs to acquire tangible assets without the capital cost (Scherrer et al., 2013). However, it is limited to assets like cars and machines (Carpenter & Petersen, 2002).

iv. **Bank finance:** Finance from banks, including overdrafts and secured long-term loans, is another funding option for SMEs (Berger &Udell, 2006). Banks typically provide overdrafts as a flexible short-term funding solution, allowing SMEs to manage cash flow fluctuations. Secured long-term loans, on the other hand, are often used for significant investments such as purchasing equipment or real estate. However, banks are conservative in their lending practices, often requiring substantial collateral or personal guarantees from SME owners, which can place their personal assets at risk. This conservative approach leads to issues like the 'maturity gap,' where there is a mismatch between the short-term nature of the funding provided by banks and the long-term financing needs of the SMEs.

3. External Source of Finance (Equity)

In addition to debt financing, small and medium sized companies may also consider equity financing options to achieve their business goals. Equity financing enables companies to access capital without incurring debt, reducing the burden of interest payment and financial risk.

Equity financing is a crucial financial mobilization method for small and medium-sized companies (SMEs). Equity financing involves the issuance of shares to investors, who become partial owners of the company (Ross et al., 2013). This method provides a source of permanent capital, as shareholders invest in the company for the long term (Myers, 1984).

Equity financing offers several benefits, including:

- No repayment obligation, reducing the burden of debt servicing (Brealey et al., 2017)
- Ability to attract investors who share the company's vision and goals (Ross et al., 2013)
- Potential for increased liquidity through listing on a stock exchange (Myers, 1984)

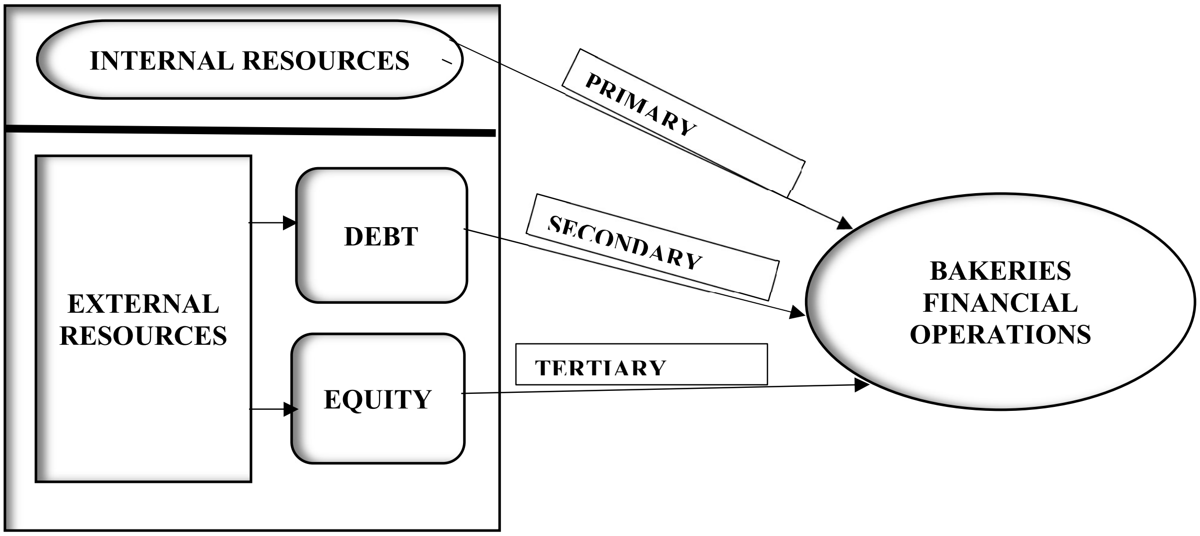

Fig 1: Financial resources mobilization methods theoretical framework
Source: Researcher (2024), Adapted from Myers and Majluf (1984).

The pecking order theory suggests that there is an order of preference for firm in respect to financial mobilization. The firm starts with internal funds before external fund (debt and equity).

Theoretical Implications

According to the pecking order theory's hierarchical capital structure, as detailed by Myers (1984) and Myers and Majluf (1984), and based on the extent of information asymmetry between managers and investors, firms' financial mobilization methods are structured in the following order of preference:

Internal financing

Companies prioritize internal financial mobilization over external sources when funding investment opportunities as suggested by Myers and Majluf (1984). This theory is based on the concept of asymmetric information, which states that company managers possess more information about the company's performance and prospects than external parties like creditors and investors (Myers, 1984). Internal financing, such as retained earnings, is preferred because it minimizes information asymmetry and is the cheapest source of financing (Myers, 1984). External financing, like debt or equity, requires companies to incur fees and is considered more expensive (Tsuji, 2011). The pecking order theory suggests that companies will only seek external financing when internal sources are depleted.

The pecking order theory has important implications for corporate financing decisions. Companies should prioritize internal financing sources, such as retained earnings, to minimize information asymmetry and reduce financing costs (Myers, 1984). External financing sources, like debt or equity, should only be considered when internal sources are depleted. The theory suggests that companies prioritize internal financing sources over external sources due to information asymmetry. Recent studies have supported this theory, highlighting the importance of internal financing sources in corporate financing decisions.

Recent studies have extensively supported the pecking order theory's predictions, consistently demonstrating that companies prioritize internal financing sources over external ones. For instance, a comprehensive study by Dang and Nguyen (2020) found that Vietnamese companies decisively prioritize internal financing and only seek external financing when absolutely necessary, aligning precisely with the pecking order theory's predictions. Similarly, Al-Mamun, Hossain & Islam (2020) conducted an in-depth analysis revealing that Bangladeshi companies also strictly adhere to the pecking order theory, preferring internal financing over external sources. A separate study on European enterprises (2015) examined capital structures and life cycles across technology and non-technology industries, finding that technology firms closely follow the pecking order theory. Moreover, research on ICT firms (2020) showed that more profitable and liquid companies maintain lower debt levels, while companies with higher risk increase their debt financing, consistently aligning with the pecking order theory's predictions. These extensive studies across various countries and industries provide robust evidence supporting the pecking order theory, highlighting the clear preference for internal financing sources over external ones in corporate financing decisions.

Debt financing

The pecking order theory suggests that companies prioritize internal financing sources over external ones, and debt financing is considered a secondary option (Myers, 1984). When internal funds are depleted, companies may resort to debt financing to meet their financial needs (Dang & Nguyen, 2020). For example, a company may issue bonds or take out a loan from a bank to finance a new project.

Debt financing can provide companies with the necessary funds to invest in profitable projects, but it also increases the risk of default and bankruptcy (Tsuji, 2011). Companies must carefully consider their debt capacity and creditworthiness before resorting to debt financing. In addition to traditional bank loans, companies can also access debt financing through alternative channels, such as peer-to-peer lending or crowdfunding (Ghosh, 2015). These options may offer more flexible terms and lower interest rates than traditional debt financing options.

Although, debt financing can also have negative consequences, such as increasing the company's debt-to-equity ratio and reducing its credit rating (Castro et al., 2015), companies must carefully manage their debt levels and ensure that they have sufficient cash flow to meet their interest payments. Debt financing can be a useful tool for companies to access necessary funds, but it must be used judiciously and with careful consideration of the potential risks and consequences.

Equity Financing

The pecking order theory also suggests that equity financing is a last resort for companies, as it involves surrendering ownership and control (Myers, 1984). Equity financing occurs when a company issues new shares of stock to raise capital from investors (Tsuji, 2011). For example, a company may issue an initial public offering (IPO) to raise funds for expansion. Equity financing can provide companies with the necessary funds to invest in growth opportunities, but it also dilutes the ownership stake of existing shareholders (Dang & Nguyen, 2020). Companies must carefully consider the potential benefits and drawbacks of equity financing before making a decision.

In addition to traditional equity financing options, companies can also access alternative forms of equity financing, such as venture capital or private equity (Ghosh, 2015). These options may offer more flexible terms and lower costs than traditional equity financing options. However, equity financing can also have negative consequences, such as diluting the ownership stake of existing shareholders and increasing the company's cost of capital (Castro et al., 2015). Companies must carefully manage their equity levels and ensure that they have sufficient cash flow to meet their dividend payments. Equity financing can be a useful tool for companies to access necessary funds, but it must be used judiciously and with careful consideration of the potential risks and consequences.

Conclusion

This review focused on investigating the financial mobilization methodsemployed by small and medium-sized bakery enterprises within the framework of the Pecking Order Theory (POT). The outcomes provide validation for the projections of the theory, illustrating that these bakeries will give precedence to utilizing internal funding avenues such as retained earnings as opposed to external sources, primarily due to cost efficiency and mitigation of information asymmetry. This preference aligned with the POT, which suggested a hierarchy of financing preferences starting with internal funds, followed by debt, and finally equity. This study concluded that, based on literature review, small and medium enterprise that primarily use internal financing methods, in line with the Pecking Order Theory's hierarchical approach, could achieve better financial health and long-term viability.

Suggestions and Implications

Suggestions

In view of the conclusion made, the following suggestions are made that:

i. Small bakery should prioritize efficient management of retained earnings to strengthen their financial stability and reduce reliance on external financing.
ii. When external financing is necessary, bakeries should carefully consider debt options to minimize costs and avoid excessive leverage, aligning with the preferences of the Pecking Order Theory
iii. Managers and Owners of firms should strive to achieve a balanced capital structure that optimizes the use of both internal and external financing sources, ensuring financial flexibility and risk management.

Implications

The findings from studies exploring the financial mobilization methods of small bakeries within the framework of the Pecking Order Theory (POT) reveal crucial implications for these enterprises. Firstly, prioritizing internal financing methods such as retained earnings can significantly bolster the financial stability and growth prospects of small bakeries. Research indicates that free cash flows derived from internal sources positively impact organizational growth and liquidity, highlighting the importance of effectively utilizing internal funds. These insights suggest that small bakeries can strengthen their financial foundations by focusing on robust internal financial mobilization method.

On the other hand, the implications caution against a blanket reliance on debt financing as practiced by firms, despite its theoretical advantages over equity financing in the POT hierarchy. Instead, the findings advocate for a balanced approach where external financing decisions, including debt, are made judiciously based on individual business needs and market conditions.

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Appendix

Table 1: Theoretical/Conceptual Literature Matrix

Author and Date	Theoretical/Conceptual Framework	Research Question(s)/Hypothesis	Methodology	Analysis & Results	Conclusions
Mubashir, Raheman, & Zulfiqar (2012)	Co-alignment among corporate strategy, financial structure, and firm performance	How do corporate strategy and financial structure affect firm performance?	Analysis of financial statements of 158 non-financial publicly listed companies in Pakistan (1998-2009)	Free cash flows positively impact growth and liquidity; negative impact of debt ratio on return	Free cash flows enhance growth and liquidity, but high debt ratios reduce returns
Younus, Ishfaq, Usman, &Azeem (2014)	Capital structure and financial performance	What is the impact of debt on the financial performance of the Sugar industry in Pakistan?	Analysis of financial performance of Sugar industry firms in Karachi Stock Exchange (2006-2011)	Insignificant impact of debt on performance; minimal financial resources needed	Capital structure has an insignificant relationship with performance in the Sugar industry
Chen (2014)	Strategic financial management practices	How do strategic financial management practices affect financial performance in Vietnamese manufacturing firms?	Examination of manufacturing firms in Vietnam	Positive impact of efficient strategic financial management on liquidity and business activity	Strategic financial management practices significantly enhance financial performance
Masoud, Babak, Mehrdad, &Farshid (2015)	Financing and investment strategies	What is the impact of financing and investment strategies on economic added value and net interest margin in Iranian banks?	Examination of 24 Iranian banks (2010-2014)	Financing strategy had no significant impact; investment strategy had a positive impact	Investment strategy enhances economic added value and net interest margin
Wan-Mohd, Norlia, Anizawati, & Wan (2016)	Impact of financing decision on performance	What is the impact of capital structure on performance in Malaysian firms?	Analysis of 76 Malaysian public listed firms (1994-2007)	Insignificant relationship between capital structure and performance	Capital structure does not significantly affect performance
Yensu, Yiadom, &Awatey (2016)	Financial management practices	How do financial management practices affect profitability in Ghanaian enterprises?	Study of 98 manufacturing and trading enterprises in Obuasi Municipality	Working capital management positively affects profitability; negative impact of capital budgeting management	Effective working capital management boosts profitability, while capital budgeting management can be detrimental
Adesina et al. (2016)	Financial risk management	How do non-profit	Field-based approach with	Different strategies	Awareness of financial risks and adoption of

	strategies	organizations manage financial risks?	interviews and document analysis	adopted to mitigate financial risks	varied mitigation strategies are crucial for non-profits
Thair (2017)	Profitability indicators and investment decisions	How do profitability indicators impact investment decisions in industrial firms?	Analysis of 10 industrial listed companies in Amman Stock Exchange (2011-2015)	Positive significant impact of profitability indicators on investment decisions	Profitability indicators are key drivers of investment decisions
Okolocha, John-Akamelu, &Ezejiofor (2019)	Impact of debt on profit	What is the effect of short-term and long-term debt on profits in Nigerian beverage firms?	Study of 8 beverage firms listed on Nigerian Stock Exchange	Short-term debt positively influences profit; long-term debt has no significant effect	Short-term debt boosts profit, while long-term debt is less impactful on profit