

## CHAPTER THREE

### GENERATING CAPITAL FOR BUSINESSES

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#### **Introduction**

The importance of capital to a successful business organization cannot be over emphasized. Capital is front and centre in the eyes of entrepreneurs. This chapter will touch on the following:

- What-is Capital?
- Who needs Capital?
- What are the types of Capital available?
- What are the sources of generating Capital?

#### **What is capital?**

Capital, from the business perspective, can be defined as wealth in the form of money or property, used or accumulated in a business by a person, partnership or company. It is regarded as material wealth used or available for use in the production of more wealth. Capital can be either owned or borrowed. Capital contributed by the owner or entrepreneur of a business and obtained for example by means of savings or inheritance is known as own capital or equity whereas that which is granted by another person or institution is called borrowed capital.

## **Who needs capital?**

All potential and existing individuals and organizations who are planning to engage or are into any form of business need financial capital in one form or the other. For the sole proprietor, those who are in partnership and organizations, the need for adequate capital is also very important.

## **Types of capital**

Funding options for starting or growing a business abounds but what we have noticed is that people often go after the wrong type of funding for their kinds of businesses. This can lead to some undesirables such as loss of control, feud between the owner and the financiers, waste of time and other nasty consequences. With this in mind, business owners need to choose the type of funding that is “just right” There are two main types of capital; equity capital and debt capital.

### **Equity capital**

This is the amount of capital provided by the owners of the business. The capital can be raised by direct injection by the owner or invitation to other interested people to be part-owners of the business. Equity capital can also be raised from the capital market for existing businesses through an initial public offer. Proceeds of such capital so raised are used to finance assets used in production and working capital. Capital Market is where long term funds are raised for business.

### **Debt capital**

The vast majority of businesses are funded in the debt capital via financial institutions that provide loans or line of credit that comes with a repayment schedule and an interest rate. They will look carefully at

the business cash flow; collaterals and the liquidity of assets Short-term debt capital can be raised from commercial banks while long-term debt capital can be raised from the capital market.

### **Sources of generating capital**

Capital can be generated through individual resources and financial institutions which include development financial institutions and deposit money banks. Those institutions are examined in this chapter.

### **Small and Medium Enterprise Development Agency of Nigeria (SMEDAN)**

Although SMEDAN is not a funding agent, we need to examine the agency in view of its role in the development of Small and Medium Enterprises. It was established by the SMEDAN Act of 2003 to promote the development of Micro, Small and Medium Enterprises (MSME) sector of the Nigerian Economy. The agency positions itself as a one-stop shop for MSME Development. Micro enterprises are included in the clientele of the agency since they form the bedrock of SMEs.

Poverty, due to lack of access to income earning opportunities and lack of capacity to take advantage of the opportunities, is a social malaise that is threatening global prosperity in general and national economic growth and development in particular. A well-developed MSME sector has proven to be one of the most veritable channels to combat poverty. The establishment of SMEDAN is, therefore, justified by the need to trigger the development of Nigeria's MSMEs in a structured and efficient manner. SMEDAN's functions include:

- Stimulating, monitoring and coordinating the development of the MSMEs sector.

- Initiating and articulating policy ideas for micro, small and medium enterprises growth and development.
- Promoting and facilitating development programmes, instruments and support services to accelerate the development and modernization of MSME operation.
- Serving as a vanguard for rural industrialization, poverty reduction, job creation and enhance sustainable livelihood.
- Linking SMEs to internal and external sources of finance, appropriate technology and technical skills as well as to large enterprises.
- Promoting information and providing access to industrial infrastructures such as layouts, incubators, industrial parks, etc.

### **Bank of Industry (BOI)**

Bank of Industry is Nigeria's oldest, largest and most successful development finance institution. It was reconstructed in 2001 out of the Nigerian industrial Development Bank (NIDB) Limited to provide long-term financial help to the industrial sector of the Nigerian economy. Its mandate includes:

- Providing financial assistance for the establishment of large, medium and small projects as well as expansion, diversification and modernization of existing enterprises and rehabilitation of ailing ones.
- BOI assists projects to generate multiplier effects such as job creation and poverty alleviation both of which invariably enhance the zonal and economic conditions of Nigerians.

- Manages foreign grants and aid that are given to facilitate attainment of the nation's developmental aspiration, the implementation of the National Economic Empowerment and Development Strategy (NEEDS), the realization of the Federal Government goal of sustainable, pro-employment of ten per cent economic growth rate per annum and the MDGs.

BOI's facilities can be accessed by:

- Small, medium and large enterprises excluding cottage industries.
- New or existing companies seeking expansion, modernization and diversification.
- Credit worthy promoters who will be required to prove their commitment to the project by contributing, at least, twenty-five per cent of the project cost excluding land.
- Borrowers whose management capability, financial situation (including availability of collateral and guarantee), character and reputation are incontrovertible.
- Clients with demonstrable ability to meet loan repayment.
- Borrowers with no record or unpaid loans to erstwhile development financial institutions and other banks.
- Industry in which Nigeria's comparative advantages would be converted to competitive ones.
- Ability to promote the expansion of exports through the production of high-quality products that are attractive to domestic and export markets.
- Niche projects that produce for worldwide consumption.
- Projects that create both forward and backward linkages with the rest of the domestic and regional economy.
- Ventures that promote inter-state and regional integration.
- Small and medium enterprises (SMEs) that have linkage with large firms belonging to clusters and operate under franchise.
- Enterprises with high employment generating capacity.

- The project must be technically-feasible, commercially-viable and economically-desirable.
- Project that is environmentally-friendly.
- Enterprises that have good management set-up and proper accounting procedures.
- Enterprises promoted by women entrepreneurs.

The bank is primarily a long-term lender. However, owing to the difficulties being experienced by BOI's customers in accessing working capital facility from commercial banks, the BOI's has entered into partnership with the commercial banks. Under the arrangement, BOI grants long term loans while the commercial banks provide the working capital.

### **National Economic Recovery Fund (NERFUND)**

NERFUND was set up to provide needed medium to long term financing to viable small and medium scale production enterprises. The objectives are; to increase the quantity of goods and services available for local consumption and export, provide needed employment, expand our production base and add value to the economy. It is, therefore, expected to specifically carry out these functions:

- Acts as a catalyst for stimulating the rapid rise of real production enterprise in the country.
- Corrects any observed inadequacies in the provision of medium to long term financing to small and medium scale enterprises, especially manufacturing and agro-allied enterprises and ancillary services.
- Provides medium to long term loans to participating banks (PBs) for on-lending to small and medium scale enterprises for the production and acceleration of production activities in such enterprises.

- Facilitates the provision of loans with five to ten (5-10) years maturity including a grace period of one to three (1-3) years, depending on the nature of the enterprise or project.
- Provides such loans either in Naira or in foreign currencies or both, according to the sources of fund available to NERFUND and the requirement of the eligible enterprise or project.

Some of the products of NERFUND include:

- **Micro Enterprise Loan** - This is a credit facility meant for establishing target industries with total cost of investment including land and building value below N5 Million.
- **SME Credit Facility** - This is traditional forte of NERFUND where it funded the establishment of 266 small and medium scale enterprises between 1990 and 1995.

To access NERFUND's facility, the first step is for the entrepreneur to convince himself of the definite type of business he or she wants to pursue. This must fall into the category of manufacturing, agro-allied, mining, quarrying, industrial support services, equipment-leasing and other ancillary services. Subsequently, the entrepreneur should try and familiarise himself with basic knowledge about the type of business by consulting existing operators and business owners. The promoter should now get help from the expert to draw up a business plan or feasibility report on the intended investment. The report/plan should be submitted to NERFUND with a letter showing the amount being applied for.

### **Bank of Agriculture**

The Bank of Agriculture is a Federal Government Development Bank with a mandate to provide low-cost credit to small and commercial farmers and small and medium rural enterprises. It also provides micro finance to small and medium scale non-agricultural enterprises. The bank's aim is to ensure effective delivery of agricultural and rural finance services on a sustainable basis to support the national economic development agenda including food security,

poverty reduction, employment generation, reduction in rural to urban migration, less dependency on imported food items and increase in foreign exchange earnings.

Its credit functions are activated at the level of direct lending, on-lending (through micro finance bank), collaboration and monitoring of credit through micro finance bank. Credit is a critical factor in development of agriculture in the rural areas and small businesses in general. This is because it aids capital formation and technology acquisition.

### **Nigerian Export- Import Bank**

The Nigerian Export-Import Bank (NEXIM) was established in 1991 as an export credit agency with the following statutory functions:

- Provision of export credit guarantee and export credit insurance facilities to its clients.
- Provision of credit in local currency to its client in support of exports.
- Establishment and management of funds connected with exports.
- Maintenance of a foreign exchange revolving fund for lending to exporters who need import to facilitate export production.
- Maintenance of a trade information system in support of export business.
- Provision of domestic credit insurance where such a facility is likely to assist exports.

The bank presently provides short and medium terms loans to Nigerian exporters. It also provides short term guarantees for a loan granted by Nigerian Banks to exporters as well as credit insurance against political and commercial risks in the event of non-payment by foreign buyers. The bank has an authorized share capital of N50Billion with N13.6Billion fully paid up.



The Bank is into direct lending to fund purchase of capital goods, raw materials, packaging materials and spare parts. It handles ECOWAS Interstate Road Transit Scheme, Export Credit Guarantee facility, Export Trade Support Facility, Foreign Input Facility, NDE's Facility, Reduction and Refinery Facility, Creative Arts and Entertainment Facility Loan and Stocking Facilities.

### **Infrastructure Development Bank of Nigeria (IDBN) PLC**

(Formerly Urban Development Bank)

IDBN Plc is a specialized financial intermediary which aims at facilitating investment in Nigeria's infrastructure. It aims at serving as the premier infrastructure development bank in Nigeria. Nigeria faces a significant infrastructure gap which is a major bottleneck to the productivity of the private sector. The country's infrastructure deficit is evident in a number of areas such as Inadequate power generation and distribution, inefficient port services and poor transportation networks, etc.

Investment in social infrastructure such as health and educational facilities all need to be accelerated. Overall, the quality and affordability of key infrastructure in Nigeria tends to be lowered than that for other comparative emerging market countries. IDBN's mission is to assist in addressing the country's infrastructure gap by facilitating private sector involvement in infrastructure. Its focus area includes: Power, Roads, Ports, Railways, Water and Sanitation, Social Sector infrastructure, Urban Mass Transportation, Housing, Real Estate, etc.

### **Federal Mortgage Bank of Nigeria (FMBN)**

The Bank was established to promote the delivery of affordable and modern houses to Nigerians. The Bank manages the National Housing Fund which is accessed by the contributors through Primary Mortgage Institutions such as Union homes. Those who are into business of providing mass housing through mortgage can benefit from the services of FMBN.

## **Commercial Banks**

These are banks whose principal function is to receive demand deposits and to make short-term loans. Efforts at raising capital from any of the development institutions mentioned above are channelled through the commercial banks.

## **Microfinance Bank**

Microfinance was defined by Gert Van Maneem, a Microfinance expert, as "banking the un-bankable" i.e. bringing credit, savings and other essential financial services within the reach of hundreds of millions of people who are too poor to be served by regular banks, in most cases because they are unable to offer sufficient collateral. A microfinance bank can therefore, be defined as "the bank for the poor". Microfinance is meant to lift the poor from his/her current level of poverty to a level of productivity and self-sufficiency.

## **Central Bank of Nigeria**

The Central Bank of Nigeria is the apex regulator of the banking system in any economy and it acts as bankers to the federal Government. As part of its intermediation role, it has in recent times, facilitated the provision of intervention funds for various sectors of the economy such as Agriculture, Energy, Aviation, Small and Medium Enterprises through the Bank of industry and Commercial Banks. The Central Bank of Nigeria's development finance initiatives are mainly targeted at agricultural sector, rural development and micro, small and medium enterprises.

## **Challenges of capital generation**

- High Cost of borrowing.

- Stringent lending conditions.
- Lack of adequate funding of the development finance institutions.
- Overlapping functions by the various financial institutions which create confusions and duplications.
- Lack of adequate knowledge of the business environment.
- Inability to produce attractive business plans/feasibility Studies.

## **Conclusion**

Some business financing options will be too complicated and some too risky. Others will offer too little or too much. But if a businessman does his homework and ask for the right amount from the right source at the right time, he will secure the financing for his business that is "just right" and will be on his way to business success.

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