# Sourcing Funds From The Capital Market:-

# A SURVEY OF THE ELIGIBILITY OF NNDC NON-QUOTED PROJECTS

**BY**

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## Declaration

I hereby declare that this project entitled "Sourcing Funds From The Capital Market:- A Survey of The Eligibility of NNDC Non-quoted Projects" is my original work. All data and works submitted have been duly acknowledged in the references.

| Mahmud Ahmed | | 22/7/99 |
|---|---|---|
| ..... | ..... | .... |
| Name of Student | Signature | Date |

## Dedication

This Research Work is Dedicated to my Family.

## Certification

This project has been carefully supervised, read and approved as having satisfied one of the necessary conditions for the award of a Masters Degree in Business Administration in the Faculty of Administration Ahmadu Bello University, Zaria.

| | |
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Mahmud Ahmed.

# ABSTRACT

No business entity can survive without finance. Considered as the live wire, finance is required as working capital and for the acquisition of fixed assets. In both cases, right combination or finance mix is essential.

With the deregulation of the Nigerian financial system, the cost of borrowing funds from the banks became increasingly expensive. This therefore made it more and more difficult for businesses to finance their working capital requirements talk-less of expansion and modernisation of operations. Consequently, a lot of them went under due to dearth of finance. Among such business entities are some that are associated with the New Nig eria Development Company (NNDC) Ltd, Kaduna. The NNDC is a Development Finance Company with investments in more than 100 companies majority of which are private and fall within the medium category.

In the light of the ever-increasing cost of bank borrowing, this study looked at the Nigerian Stock Market as a viable option for companies with potentials to raise their much-needed finances. The stock market, like banks, is an important element in the Nigerian Capital market. It came into being in 1960 and it is the most important operational institution in the Capital Market. The Stock Market supports the development as well as growth of small and medium enterprises. By 30th September 1996 a total of 184 companies were listed on the Stock Exchange and the equity market capitalisation was N252.96 billion. The Stock Market provides a safer, surer and more permanent type of capital that can be sourced either in form of debt (debenture and bond), preferred stock or equity. Each of these sources has features, merits and demerits.

Debenture and bond represent a promise to pay interest at specified dates and to repay the principal loan at maturity. Preference stock combines the features of common stock and bonds. The word "preferred" refers to the priority of claims over the common stock. Equity (or common stock) is the riskiest form of financing, even though it is regarded as the best alternative means for raising long-term finance.

The study recognised the various classifications of the Capital Market. For instance, there are organised (or formal) Capital Markets and informal ones. Whereas organised capital markets have physical facilities, governing boards and membership regulations and requirements, the informal capital markets lack almost all of these qualities. Another important classification is based on whether or not the stock to be traded is coming to the market for the first time. If it is a new issue, the segment of the market that handles such is the Primary Capital Market. However, for old stocks, their purchase and sale is conducted at the secondary segment of the Capital Market.

Several important institutions make up the Capital Market. Each plays a specialised role in the entire capital mobilisation process. Notable of such institutions are: Issuing Houses, Stock broking Firms, Commercial and Merchant Banks, Registrars, Companies, Investors, Securities and Exchange Commission and Stock Exchange.

Another important aspect that the study looked into is the theory of efficient markets. Relevant information about stocks has been found to be critical and the degree of available information determines the form of efficiency the market has. There are three forms viz: the Weak form, the Semi-strong form and the Strong form.

The price behaviour of equity was also studied. There are three schools of thought in this regard and they are: Technical Analysis School, Fundamental Analysis School and Efficient (or Random Walk) Market School. Each of these schools advanced arguments on how the price of a security is determined.

A generalised review of the performance of the Nigerian Stock Exchange was made. It was discovered that the performance of the 34 companies, which the Federal Government divested from between 1989 and 1993, recorded significant improvement after listing on the Nigerian Stock Exchange. The International Finance Corporation (IFC) adjudged the Nigerian Stock Market as at July 1997 the second highest in the World in terms of total returns that accommodates capital appreciation and accrued dividend paid by quoted stocks.

This study looked at eight NNDC associate companies whose performances dwarfed owing to financial problem. Previous efforts by their respective Boards to re-capitalise through Rights Issues were met with varying degrees of low responses. Neither could the companies successfully raise funds from the bank because of relative poor performance and the attendant exorbitant cost of borrowing. The study therefore found out that when adequately encouraged such companies could definitely find a safer, surer and more permanent source of raising funds from the Stock Market for their working capital requirements and modernisation/expansion programmes.

It is for the above reason that this study is recommending as follows:

i) Those NNDC associate companies with good future prospects should be encouraged to go public;

ii) Certain fundamental problems such as inefficient management that bedevil the companies should first be addressed prior to their going public;

iii) The companies should get listed into the Second-Tier Market because the listing requirements there are softer than those in the First-Tier;

iv) Owing to the numerous advantages of equity financing such as the absence of obligatory payments to equity holders, the companies should raise additional funds only through the issuance of common stock (equity).

It is hoped that the ailing NNDC associate companies, which are spread all over, the North will have a new lease of life once they are quoted on the Stock Exchange. The Stock Market promotes corporate financial discipline, accountability, transparency, solvency, efficiency and competitiveness. All these are expected to reverse the erstwhile poor performances of the companies, which will in turn improve the socio-economic well being of the North.

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# CHAPTER ONE

## 1.1 Introduction

Finance is an important resource in business. It is like blood in the human body and its deficiency will bring a business to a halt.

Finance is required as a working capital and for the acquisition of capital items. Working capital refers to the circulating current assets resources and normally has two components namely - permanent working capital and variable working capital. Whereas permanent working capital is required on a continuing basis throughout the year, variable working capital on the hand is required at different times during the year. In essence, the permanent working capital represents the minimum resource requirements for carrying operation while the variable working capital represents additional resources that are needed at different times.

Components of working capital are:- inventories (of raw materials, purchased parts, finished goods etc), accounts receivables (i.e. trade credits extended to customers), and cash. Others include accounts payable (i.e. credit provided by suppliers), overdrafts and other short-term liabilities.

In financing working capital, current assets are usually financed from combination of short term and long-term sources. Variable working capital should be financed

from short-term sources only for periods needed. Cash and receivables can be matched against current liabilities. Inventories and other assets should be financed from long-term sources.

In undertaking capital projects such as the purchase of machineries and acquisition of other fixed assets, long-term funds are preferred. In fact, proper matching of funds whereby capital projects are financed with long-term is very crucial to the success of an enterprise.

Following the deregulation of the financial system, long-term funds from the banks became increasingly expensive. As banks arbitrarily fix their lending rates, small and medium enterprises are worst hit by the resultant high cost of borrowing. Even the larger productive enterprises are starved of funds because of their inability to recover such high costs in the pricing of their products due to consumer resistance.

Other adverse effects arising from the deregulation of the economy such as low disposable income and low capacity utilization, to mention a few have compounded the financial problem of many companies. For example, shareholders in a bid to be better off put a lot of pressure for the declaration of a substantial part of their companies' meager profits as dividends. The companies are therefore left with little retained profit which is in most cases insufficient to finance new

investments in fixed assets or working capital. Under-capacity utilization has rendered many industrial enterprises unable to service existing loans. This in turn has scared them from going for additional loans to finance capital items and certain components of working capital.

It can be noted, therefore, that many Nigerian enterprises are starved of funds. There is a wide gap between what they actually have from internally generated revenue and what they require to carry on operations. The shortfall between the available internally generated funds and the required finance should be obtained through, at best, the capital market.

1.2 The Nigerian Capital Market

The Capital Market is essentially the place where long-term funds are obtained. The capital market in Nigeria induced and fostered by the Federal Government due to the understanding that a viable equities market could be relied upon to finance industrial growth.

The first major move towards developing the market was the constitution of a Committee in 1958 under the Chairmanship of Professor R.H. Barback to advise on ways and means of promoting or fostering a stock market in Nigeria.

Prior to 1958, all idle investible funds in Nigeria were invested on the London Stock Exchange. After the Barback Committee Report was published in 1959, its recommendations culminated in the pioneering and promoting of the Lagos Stock Exchange with the following foundation members[1] :-

1. C.T.Bowring & Co. Nig. Ltd - Stockbrokerage Firm.
2. Chief Theophilus Adebayo Doherty - Businessman
3. John Holt Nig. Ltd - Investment & Trading Co.
4. The Investment Co. of Nig. Ltd (ICON) - Investment Bank & Stockbrokerage firm.
5. Sir Odumegwu Ojukwu - Businessman & First Chairman/President
6. Alh. Shehu Bukar - Businessman
7. Mr. Akintola Williams - Chartered Accountant

The Nigerian Capital Market is composed of the following key participants[2] :-

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Notes

1. Memorandum to the Panel on the Review of the Nigerian Stock Market by the Nigerian Stock Exchange, 1996.

2. Utilization of the Nigerian Capital Market: Benefits of Stock Exchange Quotations, Seminar paper delivered by Mr. R. Oladejo in 1991 in Kano.

- The Nigerian Stock Exchange;
- The Securities and Exchange Commission;
- Public Debt Office of the Central Bank;
- Development Banks and Development Finance Institutions;
- Stockbroking Firms and Share Registrars;
- Merchant Banks and Issuing Houses;
- Institutional Investors, e.g. Pension Funds and Insurance Companies;
- Leasing Companies, Unit Trust and Venture Capital Companies.

The Nigerian Stock Exchange is perhaps the single most important operational institution in the Capital Market. The Exchange is infact the hall mark of the Nigerian Capital Market, hence the Stock Exchange and Capital Market are often used interchangeably.

The Capital Market, particularly through the Nigerian Stock Exchange supports the development of small and medium scale enterprises as they are important in the nation's industrial development.

If fully developed and supported, small and medium scale enterprises tend to use less capital per worker than large enterprises do, not only because of difference in the type of products made but also because of differences in the technology used to make the same product.

By combining more labour with capital, small and medium

enterprises can also use capital more productively. For this reason, they have significantly higher ratios of value added for fixed assets than do large firms.

Small and medium enterprises occupy a high useful niche in the industrial sector, sub-contracting with larger firms engaging in small batch production, made-to-order work or finishing operations complementary to large-scale industry.

The Federal Government's Vision 2010 is aimed at accelerating socio-economic development. Thus, a well articulated and effectively executed industrialization strategy is not only an integral part of this Vision for a better Nigeria, but is indeed an essential bedrock. Therefore, now more than ever, is the most auspicious time to fully integrate small and medium scale business enterprises into the mainstream of the nation's economic development, through the immeasurable opportunities prevalent in the Capital Market.

The Nigerian Capital Market has come a long way since its inception, having provided facilities for the flotation of close to N30 billion in the past decade for industrial and social infrastructural development. As at 30th September 1996, there were a total of 184 listed equities on the Nigerian Stock Exchange of which 20 were on the Second-tier Securities Market (SSM).

The equity market capitalization as at that period was N252.96 billion[3] . Obviously, many more domestic companies should access the market for funds and get listed on the Nigerian Stock Exchange for the numerous benefits derivable from so doing.

1.3 STATEMENT OF THE PROBLEM

Owing to the importance of small and medium scale businesses to the Nigerian economy, a lot has been done to promote them. For example, the Indigenisation legislations have reserved certain areas of economic activities exclusively to the indigenous entrepreneurs. The Federal Government has promoted specialized institutions such as Nigerian Industrial Development Bank (NIDB), Nigeria Agricultural and Cooperative Bank (NACB), National Directorate of Employment (NDE), Nigerian Economic Reconstruction Fund (NERFUND), Peoples Bank, Community Bank and recently Risk Fund Scheme to provide technical and financial support to indigenous businesses.

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3 Remarks by Mr. George A. Akamiokhor, Director General SEC at a workshop on Opportunities in the Nigerian Capital Market jointly organised by SEC and Kaduna Chamber of Commerce on October 8th, 1996

Inspite of these laudable efforts, there are a number of formidable constraints affecting small and medium enterprises. One of such constraints is shortage of finance.

Financial institutions in the country generally regard small and medium enterprises as high risk ventures. Consequently, they are skeptical in granting them credit without substantial collaterals which the enterprises often cannot provide. For this reason, such enterprises invariably rely on their savings, internally generated funds or informal credit markets which are inadequate for expansion and modernization.

There are several cases where some NNDC associate companies have suffered from severe financial problem that rendered them either temporarily out of operations or operated at very low capacity. There are still many others presently that are financially starved and there are no indications that the shareholders will come to their rescue in the foreseable future.

The cash crunch hinders the realization of the enormous benefits of the small and medium enterprises which are vital to the quest for rapid industrialization. Furthermore, a fundamental objective of the NNDC - the desire to promote and enhance rapid economic and industrial development of the North is seriously being threatened.

## 1.4 OBJECTIVES OF THE RESEARCH

The objectives of this research are the following:-

(a) to identify the major sources of finance in the Nigerian Capital Market;

(b) to examine the merits and demerits of the sources; and

(c) to recommend appropriate sources to the NNDC unquoted projects in dare need of funds.

## 1.5 SCOPE OF THE STUDY

The Nigerian Capital Market is comprised of the banking system, the money market and the stock market. The study is restricted to the Stock Market where equities and debt instruments are sold and bought.

The scope of the work is as follows:-

(i) Only those non-quoted companies that are presently in serious financial problems will be studied;

(ii) The companies will be assessed with a view to meeting the requirmeents of the Stock Market.

## 1.6 THE HYPOTHESES

The hypotheses for this study are:-

(i) Existing shareholders will not put additional finance because returns on their investments are not encouraging.

(ii) The companies' poor performance coupled with

the stringent conditions of banks make borrowing difficult.

(iii) The companies can raise cheap funds from the Stock Market.

1.7 SIGNIFICANCE OF THE STUDY

This study is aimed at achieving the following:-

(i) If the companies are quoted on the Nigerian Stock Exchange, their peculiar operational problems such as lack of finance, incompetent management and heavy debt burden would be overcome.

(ii) Healthy and profitable operations of the companies will impact positively on the socio-economic development of the North in particular and the country in general.

(iii) Besides enhanced returns in the form of dividends that are expected to accrue to NNDC as a result of post-listing improved performance of the companies, an important objective of the NNDC is to assist in the growth of the Capital Market.

## 1.8 METHODOLOGY

For this research, two methods were widely used. They are review of literature and administration of questionnaires. Published works on Capital Market were extensively consulted. Similarly, records and relevant documents in NNDC were made use of. Questionnaires and interviews were also used.

## 1.9 LIMITATIONS OF THE STUDY

In the course of producing this work, some difficulties were encountered. One of such difficulties is the non availability of most latest audited accounts of the companies studied. Secondly, the study initially was to consider as many companies that are in financial trouble as possible. However, only eight companies were studied and the reason is that some of the others have stopped operations long ago and as such available information in respect of them is considered stale. Thirdly, great care has been taken not to disclose the identities of the companies because they are strictly private as at the time of this study. In the same vein, performance figures have not been disclosed, but rather the general trend, especially with regards to turnover and profitability, was commented.

## 1.10 HISTORICAL BACKGROUND OF NEW NIGERIA DEVELOPMENT COMPANY (NNDC) LIMITED

The New Nigeria Development Company (NNDC) was incorporated as a limited liability company in 1968. It however started as Northern Regional Production and Development Board (NRPDB) in 1949. The company witnessed over the years several changes and experienced a number of transformations both in terms of structure, business focus as well as in its scope of operations resulting in the birth of most dynamic investment holding in the country.

Accordingly, NNDC provides today modern Development Banking Services that are responsible for the modest achievements recorded in the economic, industrial and human resource developments of its shareholder states in particular and the nation in general.

CORPORATE OBJECTIVES

NNDC's Corporate objectives are articulated in the following Mission Statement:-

> "....to be a diversified holding company that derives its financial strength from steadily increasing profitability as well as managing equity investments and operating selected businesses within industries having superior economic and growth potential."

The company's specific objectives are however the following:-

(i) To engage in activities which will promote and enhance rapid economic, industrial and human resource development of the Owner States in particular and the country in general;

(ii) Direct investment in Agriculture, Industry, Mining, Commerce and Service Sectors of the economy;

(iii) Effective Supervision of Investments;

(iv) Provision of Consultancy Services in various field to Governments, Companies and Industries;

(v) Assisting owner state investment agencies in such areas as Research, Project Promotion and Development.

(vi) Ensuring improved efficiency of enterprises within the control of NNDC through mergers, acquisitions and takeovers etc.;

(vii) Assisting in the growth of the Capital Market in Nigeria; and

(viii) To serve as a training institution for managers within the financial and industrial sectors of the Nigerian Economy.

OWNERSHIP

NNDC is currently owned by the Governments of the Nineteen Northern States in varying percentage holdings. The share capital of the company is N250 million made up of 250 million shares of N1.00 each.

ORGANIZATION AND FUNCTIONS

NNDC has a Board of Directors which is made up of a Chairman, a Managing Director/Chief Executive and one representative from each of the nineteen owner states. The Board is responsible for the formulation of policies on investments, resource allocation, appointment of management staff and so on.

There are four Departments each headed by a General Manager, who is responsible to the Managing Director. The Departments are:-

- o Business Development;
- o Investment Supervision;
- o Corporate Services and
- o Commercial

The Business Development Department performs the following functions:-

- Establishment, Management and administration of the company's planning process;

- Identification, appraisal and promotion of all new investments subject to the company's investment requirements and procedures;
- Securing assistance of external bodies in the identification of joint venture/technical partners for industrial projects in NNDC owner states;
- Liaison with external bodies for participation in ventures promoted by NNDC and its owner states.

The Investment Supervision Department performs the following:-

- monitoring of all existing investments in the subsidiary, associate and other companies;
- Maintenance of a satisfactory and mutually beneficial relationship between NNDC and its Subsidiary and associate companies;
- Offering advise to companies in which NNDC is invested in order to ensure the attainment of the Corporate Objectives of the companies;
- Maintenance of a Data bank for the purpose of effectively monitoring the performance of NNDC investments.

The Corporate Services Department on the other hand performs the following functions:-

- Provides all the necessary support services needed for the day to day running of the company such as finance and accounts, personnel and administration etc;
- Assesses the manpower and training needs of NNDC;
- Provides legal advice to NNDC, its subsidiaries and associates.

The Commercial Department is primarily engaged in general commercial activities aimed at boosting internally generated revenue of the company.

NATURE OF ACTIVITIES

NNDC engages in the following activities:-

(i) Provision of medium and long term loan;

(ii) Equity Participation;

(iii) Project planning, development and management;

(iv) Feasibility Report Writing;

(v) Investment Advisory Services;

(vi) Legal and Secretarial Services;

(vii) Sourcing of foreign finance;

(viii) Development of Managerial skills;

(ix) Hotel Development and Management;

(x) Real Estate Management;

(xi) Merchant and Commercial banking services; and

(xii) Computer-related Consultancy Services.

INVESTMENT CRITERIA

Any project seeking NNDC's participation either through equity or loan investment is appraised with a view to determining whether or not it satisfies the requirements defined by the following criteria:-

(i) Profitability

All projects must be capable of generating a return on investment of at least 5% above the minimum Rediscount Rate of the Central Bank of Nigeria.

(ii) Gestation Period

All projects must be capable of generating dividends not more than 3 years after commissioning.

(iii) Quality of Management

The quality of the management of a proposed venture is thoroughly appraised. Likewise where foreign technical partners are involved, NNDC must be fully satisfied with their level of competence and integrity.

(iv) Credibility of Project Sponsors

Project sponsors must be of proven integrity and reputation.

(v) Eligible Industries

As a policy, NNDC does not invest in brewery and tobacco. Outside these two sectors, projects requiring NNDC's participation could come from any other sectors of the economy. A project is attractive to NNDC if it meets the following attributes:-

- minimal competition.
- reasonable entry/exit barriers.
- minimum regulatory influence.
- ability to source raw materials locally.
- existence of a reasonable market for the products and/or services.
- acceptable risk/return profile.
- minimum supplier/buyer influence.
- synergy with existing NNDC investments.

(vi) Dominant Shareholder Position

NNDC does not participate in the equity of an enterprise where a single investor (and his family) holds more than 40% of the shareholding.

The idea is to spread ownership and risk and thereby protect NNDC investment from the possibility of undue influence by a single investor.

(vii) NNDC Shareholding

NNDC would not normally take less than 10% or more than 25% of the equity of an enterprise except in circumstances where NNDC itself is promoting the venture.

(viii) Geographical Spread

NNDC's principal areas of operation are its shareholder states. However, it does operate outside the shareholder states if it is in the interest of the company and its shareholders to do so.

(ix) Product

Any product manufacturing enterprise must ensure that the local content of the product is substantial. Furthermore, NNDC prefers to be involved in products with a considerable potential for export.

(x) Project Size

The total project cost must not be less than N1,500,000.

INVESTMENT PORTFOLIO

NNDC is presently involved in 41 quoted and 72 non-quoted companies spanning various key sectors and sub-sectors of the economy. The distribution of the investments along sectorial basis is as follows:-

| | Sector | | No. of Investment |
|---|---|---|---|
| 1. | Banking, Insurance and Security Services | - | 19 |
| 2. | Hotels | - | 19 |
| 3. | Food, Drugs and Beverages | - | 13 |
| 4. | Textiles | - | 12 |
| 5. | Building Materials | - | 11 |
| 6. | Construction & Allied Services | - | 7 |
| 7. | Conglomerates | - | 7 |
| 8. | Petroleum and Chemicals | - | 5 |
| 9. | Metal Products | - | 5 |
| 10. | Packaging | - | 4 |
| 11. | Transport | - | 3 |
| 12. | Industrial Domestic Products | - | 2 |
| 13. | Printing and Publishing | - | 2 |
| 14. | Plastic and Palm Kernal | - | 2 |
| 15. | Stationery | - | 1 |
| 16. | Leather | - | 1 |
| | Total | = | 113 |

# CHAPTER TWO (2)

## THE CAPITAL MARKET (1)

### 2.1 Introduction

This chapter will look into the various definitions of the Capital Market, its functions within the economy and the numerous sources of long-term finance.

### 2.2 Definitions

The word "capital" has several meanings. According to the New Encyclopedia Britannica[1], "capital" in economics refers to "a stock of resources that is employed in the production of goods and services... and there are two forms ... money or financial capital and capital goods (which are tangible)."

Capital goods are such things as buildings, machinery, and equipment produced and used in the production of other goods and services. In this research work, our emphasis is on the first part of the definition of capital above, i.e. on money or financial capital.

On the other hand the word "Markets" in the most literal and immediate sense are "places in which things are bought and sold .. (and) in the modern industrial system, (markets)..

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1 - The New Encyclopedia Britannica, Vol.2, Ready Reference (C) 1989 by Encyclopedia Britannica, Inc.

include the whole geographical area in which sellers compete with each other for customers[2]."

Money capital is required in order to finance the acquisition of real capital or capital goods. Ordinarily, therefore, Capital Market, from the definitions of "capital" and "market" above refers to the market where long-term funds are raised. However, it is worthwhile noting the following definitions of Capital Market:-

J.O. Aderibigbe defines capital market as "the market for dealings (lending and borrowing) in longer term loanable funds and equity shares[3]." On one hand, Iqbal Mathur sees capital market as a collection of players "who engage in facilitating the buying and selling of securities...(and the players are) brokers, brokerage houses, stock exchanges, dealers and so forth.."[4]

As for Ekop Ebong, in the capital market "the stock in trade is money which is available for a period extending beyond one year."[5]

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2 - New Encyclopedia Britannica, Vol. 23 (C) 1989 by Encyclopedia Britannica, Inc.

3 - Paper on Money and Capital Markets in Nigeria presented by J.O. Aderibigbe and published in the Bullion, Vol.2 No.2 of March-June 1997 Edition.

4 - A text on finance by Iqbal Mathur.

5 - A paper presented on How to make your business grow via the Nigerian Capital Market by I.E. Ebong at a seminar organized by Nigerian Stock Exchange in 1991 in Kano.

Dougall/Gaumitz as quoted by Alile and Anao see the capital market as "the complex of institutions and mechanisms through which intermediate-term funds and long-term funds are pooled and made available to business, government and individuals and instruments already outstanding are transferred."[6]

Thus, from the above definitions, the capital market embraces the entire financial system involved in the provision of long-term funds. The financial system comprises of the banking system, the money market and the stock market.

In business, capital (or long-term finance) refers to an item in the balance sheet representing that part of the networth of an enterprise that has not been produced through the operations of the enterprise.

## 2.3 FUNCTIONS OF THE CAPITAL MARKET

The role of the capital market within the economy is to offer enterprises new and wider opportunities of obtaining the financial resources they need for expansion and efficient operation. The market caters mainly for long and medium term investment and governments as well as individuals can have access to the funds made available through the capital market.

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6 - Quoted in The Nigerian Stock Market in Operation published by H.I. Alile and A.R. Anao in 1989.

Bruce Lloyd[7] summarizes the functions of the capital market as follows:-

- It provides a means for raising finance to assist companies to grow through the provision of finance which enables companies to undertake additional capital expenditure;
- It is a means of allocating the nation's real and financial resources between various industries and companies;
- It provides liquidity for the investment funds from the stand point of any single investor;
- It is a measure of confidence in the economy and serves as an important leading indicator of economic activity;
- It provides industrial management with some idea of the current cost of capital and this can be important in determining the level and rate of new investment;
- It can act as a vehicle for broadening the ownership base from the previously family dominated firms.

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7 - Quoted by Chris Ogunbanjo in his article The Entrepreneur and the Capital Market published in Bullion Vol. 6 No. 2 of April/June 1981.

## 2.4 SOURCES OF LONG-TERM FUNDS

The capital market provides a safer, surer and more permanent type of capital. Long-term funds are provided from both external and internal sources. The main internal source is retained earnings, that is earnings not paid out to shareholders as dividends. The external sources are debt, leasing, preferred stock, and equity. The external sources are explained below:-

(i) Debt Financing

Long-term debt financing, like any debt, is an obligation that is repayable at maturity over a long period. Long-term borrowing is done by selling bonds which are promissory notes that oblige the issuer to pay interest at specific times. Secured bond holders have prior claim on the assets of the bond issuer. There are two important debt instruments in the capital market and they are debenture and bond.

(a) Debenture

This is a written promise by a company undertaking to pay interest on a debt on specified dates and to repay the principal at a specified time.

Debentures may be ranked in preferential order. A subordinated debenture is the one that is ranked behind another. Its claim in the event of bankruptcy will only be honoured after the claims of senior debt holders are settled. It is important, therefore, to state in the debt contract the specific groups of debt that rank ahead of the subordinated debt. Subordinated debentures are favoured by companies because they do not hinder future financing. When money is borrowed later, those who advance the funds can be given a superior rank.

Debentures are normally unsecured. However, they may be secured by a floating charge, specific charge or even by a general lien. A debenture issued on the security of a specific assets is called a mortgage debenture.

A debenture may be specific as to redemption date. Occasionally, there is a sinking fund made up of specific periodic amounts set aside from profits to meet the repayment.

Debentures are protected by certain indenture restrictions. The following indenture provisions are common:-

i) Provisions against the issuance of more debt;

ii) restrictions that limit dividend payments;

iii) provisions restricting merger; and

iv) restrictions on the disposition of the company's assets.

(b) Bond

A bond represents a promise by a company to pay a fixed sum of money at a specified maturity date, and interest at regular intervals until then. Bonds could be issued out in the names of designated parties, i.e. as payees, or made payable to the bearer in order to facilitate handling.

Types

Bonds are of various types. Some of the prominent ones are mortgage bond, collateral trust bond, convertible bond, income bond and linked bond.

A mortgage bond is secured by specific property such as land and buildings. If only one specific asset is pledged, the mortgage is said to be a specific mortgage. If the mortgage covers a number of assets, it is called a blanket or general mortgage. In the event of default, holders of mortgage bonds receive ownership of the mortgaged property.

Collateral trust bond is one for which other securities have been pledged as collateral. Collateral trust bonds are frequently used by a parent company when it pledges the securities (i.e. stocks and bonds) of its wholly owned subsidiary as collateral.

Convertible bonds are those that are exchangeable into other securities such as equity and preferred stock at the option of bondholders. Bondholders will usually convert when they see a chance to increase their economic worth by making the switch. When a company includes the

conversion feature in bond indenture, it must have available sufficient unissued shares to accommodate all bondholders who elect to convert.

An income bond (also known as adjustment bond) is one on which interest is payable only if earned. Income bonds are often issued during a corporate reorganization to readjust fixed interest debt.

Linked bonds are those bonds where the value of the principal loan, and sometimes the amount of interest, is linked to some standard of value such as commodity prices, a cost of living index, a foreign currency or a combination of these.

Features

Bonds have the following features: fixed interest rate, maturity, presence or absence of a lien on property, trustees, sinking funds and call provisions.

Bondholders receive fixed interest as a return for the use of their money.

The interest must be paid whether or not profits are made and bondholders can take legal action if they are not paid the interest.

Bonds have maturity dates when the company agrees to pay off the outstanding bonds in cash at a certain date in the future. The company usually reserves the right to repay the bonds ahead of the due date.

Bonds are characterized by the measure of protection they provide to the bondholder. Secured bonds are the safest type of bond. Other types such as debenture bonds are not secured.

Banks and other reputable financial institutions are usually appointed as trustees to bond issues. The role of trustees is to safeguard the interest of bondholders. An agreement, called the indenture, is entered between the company issuing bonds and the trustee specifying the following:-

(i) rights and obligations of the issuing company;

(ii) The duties of the trustee;

(iii) the rights of the bondholders.

The trustee performs the following duties:-

(i) signing of each and every bond issued by the company;

(ii) making sure that no more bonds are issued than authorized;

(iii) collecting cash from the company and paying bondholders as interest and principal repayments.

(iv) checking on the company to see if the terms of the indenture are being carried out;

(v) submitting annual reports to bondholders stating that the company appears to be conforming to the terms of the indenture.

For bonds issued with a sinking fund provision, the company makes periodic payments to a trustee. Sinking funds could be based on fixed mandatory payments to the trustee or based on variable payments, i.e. payment is

dependent on earnings. The trustee uses the sinking fund payments to retire a portion of the outstanding bond issue.

A call provision in the indenture gives the company the right to call in for redemption or retirement of all or a portion of the bond issue outstanding. This provision specifies a call value or the price at which the bond is to be redeemed.

CRITERIA FOR EVALUATION

Joseph F. Bradley[8] gives six criteria for the evaluation of a bond issue from the stand point of the company. The criteria are:- cost of funds, fixed periodic payments, length of use of the funds, collateral, managerial restrictions and voting rights of bondholders.

Cost of funds

An outstanding advantage of bonds issued in reasonable amounts is that under most money-market conditions they are a cheaper source of funds than either common stock or preferred stock.

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8 - Joseph F. Bradley, Administrative Financial Management fourth Edition published by The Dryden Press, 1979

The lowest yield that a company can offer on its bonds is influenced by the rate of interest that investors can obtain on long-term government bonds. Therefore, the best time to sell bonds is when yields are low.

Fixed Periodic Payments

The general rule is that a company must make regular payments on its bond issue or face bankruptcy. However, there is an exception to the rule. In the case of an income bond, interest is payable only if earned.

Length of use of Funds

Ideally, management prefers to have the use of bondholders' money indefinitely but with the right to repay the debt at its option. A bond issue with a sinking fund requires the company to set aside a certain sum of money periodically in order to retire a portion of the debt. Instead of having all the debt come due at one time, the company makes provision for paying off some of the bondholders each year. Or, it may retire all the bonds or a large portion of them by maturity.

Collateral

The pledge of collateral gives one group of creditors limited priority over another group.



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Hence, the group whose claims are so secured have a slightly safer investment than those whose claims are unsecured. In return for safety, this special group of creditors may be satisfied with a lower return. A company, therefore, pledges collateral because of benefits to itself, that is, the cost of capital of the bond issue is reduced. Properties such as land and buildings are offered as collateral.

Managerial Restrictions

Bonds limit managerial freedom. Because restrictions on management increase the safety of the bond issue, bondholders may accept a lower rate of return than they would accept without such provisions. Typical of the major restrictions on management are:-

(i) restriction on dividend payment to holders of common and preferred stocks unless designated financial ratios are above minimums as might be stated in the indenture;

(ii) the company can not purchase its own stock unless certain financial ratios are above a specified minimums;

(iii) the company cannot issue additional bonds unless a certain percentage of the bondholders approve;and

(iv) the company cannot merge or otherwise combine unless a certain percentage of the bondholders approve.

Voting Rights

Bondholders do not have any inherent rights to participate in voting process. Nevertheless, however, they may have two types of voting rights viz:-

(i) the right to vote for directors when interest payments are in default for a certain number of periods, and

(ii) consent voting rights, where they can approve or disapprove certain proposed actions of the directors.

Advantages of Bond financing

Bond financing has a number of advantages, and they are:-

(i) Bonds carry lower cost than either common or preferred stock,

(ii) interest is fixed and is not affected by increase in earnings and sales;

(iii) bondholders are creditors and except in the case of default, do not participate in the management of the company;

(iv) bond financing allows for considerable flexibility in financial structure planning.

Disadvantages

The disadvantages of bond financing are the following:-

(i) because of indentures and covenants, company's financial mobility may be limited in future years, e.g. provisions on certain minimum financial ratios may make the company inefficient in the management of its current assets, current liabilities or capital structure;

(ii) bonds have a fixed maturity date and must be retired when they mature;

(iii) there is a limit to how much debt financing by a company is going to be deemed acceptable by its creditors.

(ii) Leasing

A lease is a contractually established obligation by the lessee to pay the lessor a series of payments for the use of certain

assets. A lease requires a deposit or some form of advance payment. There are two parties to a lease namely lessor and lessee. A lessor is the owner of the property or equipment who receives rent for the use of the assets. A lessee, on the other hand, is the user of the property who pays rent to the owner.

Types of Leases

There are two major types of lease arrangement namely operating leases and financial leases. Operating leases are cancelable and generally written for a shorter period of time than financial leases. With an operating lease, the lessor takes responsibility for virtually all the expenses of ownership. Thus, an operating (or service) lease allows the lessee to terminate the lease at his convenience. Operating lease payments usually include charges for servicing and maintaining the leased equipment.

Financial leases are long-term or intermediate term, non cancelable agreements. The lease often runs for the life of the asset or covers a period of time sufficient for the lessor to recover the cost by way of rents.

It cannot be terminated. It is similar to debt. A purchase option is often included in a financial lease agreement. The option includes a price at which the lessee can purchase the asset from the lessor at termination of the lease.

Sale and lease back and leverage lease are two special types of financial lease. Under the sale and lease back, a firm sells an asset it presently owns to a lessor and enters a financial lease agreement to "reobtain" the asset's services.

Leverage lease is a financial lease agreement in which the lessor borrows some portion (usually greater than 50%) of the purchase price of the leased asset.

The lessor secures the loan by pledging both the asset and the stream of lease payment.

Net leases are leases that require the lessee to maintain the leased asset, insure it, and pay any property taxes. Most financial leases are net leases. In a gross, maintenance, or full service lease, however, the lessor has the responsibility for the costs normally associated with ownership. Net leases not

only require that the lessee bear the normal costs of asset ownership, but also that the asset be returned in its original condition upon the termination of the lease.

Features

A financial lease includes the following features:-

1. The lease is noncancellable. The lessee cannot "walk away" from the lease without becoming liable for the remaining lease payments.
2. The lease is fully amortised. A fully amortised lease is one that returns to the lessor all his costs plus a reasonable return.
3. A financial lease does not include repair and maintenance services. A variation of the financial lease in which the lessor pays the maintenance and insurance costs is called a maintenance lease.

Special features of a sale and leaseback arrangement are as follows:-

1. Assets involved can be either old or new.
2. Assets are sold at or close to appraised market value.

3. The leaseback arrangement calls for lease payments that return all costs plus a fair return to the lessor.

Advantages

The following are some of the advantages of lease financing:-

(i) Leasing offers the advantage of placing the risk of obsolescence on the shoulders of the owner. If more efficient equipment becomes available, the lessee need not renew the lease.

(ii) When accompanied by an option to purchase, the lease permits the lessee to determine the productivity of the equipment before he purchases it.

(iii) A company can get along with fewer assets if it leases. Thus, the owners will not need to place as much of their own funds in the business. The possibility of renting capital is especially important during the promotion stage because at this time there is likely

to be much difficulty in raising funds.

(iv) A company might find it cheaper to lease than to buy an asset.

(v) Leasing has the advantage of not placing numerous restrictions on management as is the case with debt financing.

(vi) Leasing has the advantage of lessening book-keeping costs. There is no need to keep detailed records on depreciation, repairs, and the many other items that accompany ownership of property.

Disadvantages

Some of the disadvantages of leasing are the following:-

(i) In some cases, outright ownership will be cheaper than leasing the property.

(ii) Most leases require the payment of a minimum fixed sum of money each year. With owning the asset, however, a number of ownership costs become variable expenses. Thus, management finds a certain amount of

financial security in having a relatively large proportion of its outlay variable rather than fixed.

(iii) Preferred Stock

Preference stock combines the features of both common stock and bonds. The word "preferred" refers to the priority of claims over the common stock. Preferred stock resembles common stock in the following ways:-

(a) both common stockholders and preferred stockholders are part owners of the business.

(b) the company is not obliged to pay a fixed return on either of these securities, the returns depending on the availability of profits and the willingness of the directors to pay dividends.

(c) both are entitled to a return only after all costs have been provided for or paid.

The main differences between common stock and preferred stock are:-

(a) Preferred stockholders have priority over common stockholders in the receipt of dividends.

(b) There is usually an upper limit on the amount of dividends that can be received by preferred stockholders.

(c) Preferred stockholders do not usually have the permanent right to vote for directors.

The issuance of preferred stock will impact on earnings per share and price-earnings ratio of the common stock. The use of preferred stock will usually result in higher earnings per share on the common stock than if additional common stock were issued to provide funds for expansion.

Features

The features of preferred stock are the following:- par value, cumulative dividends, convertibility and participatory.

Par Value

The par value for a preferred stock is not a nominal amount. Because preferred stocks are similar to bonds in many respects, the convention is that new preferred stocks are

sold at a price very close to their stated par value. Preferred stock dividends are usually expressed as a percentage of the par value.

Cumulative dividends

Many preferred stocks carry the cumulative provision. Dividends omitted on a cumulative preferred stock have to be paid before any dividends can be paid on the common stock. The cumulative feature assures the preferred holder that dividends in arrears will ultimately be paid if the company's earnings are sufficiently high.

Convertibility

This is a provision which permits holders of preferred stock to convert their preference shares into other securities at their option. The conversion is usually into junior security - particularly common stock. This feature makes preferred stock more attractive to investors.

Participating

A participating preferred stock participates in the company's earnings growth. A general type of participation feature allows the dividends on preferred stock to increase if the dividends on the common stock exceed a

specific limit.

Criteria for Evaluation

Preference stock can be evaluated on the basis of the criteria outlined by Bradley[9] as follows:-

Cost of funds

A company is never under any obligation to pay dividends on any ownership security unless there is some unusual provision in the charter. All the preference feature does is to state that if any group of stockholders receives dividends, then the preferred stockholders will receive their dividend first.

Preference stock dividends are usually cumulative and slightly safer than common stock within the same company. Holders of cumulative preference shares must be paid all that is due to them of their dividends whenever cash becomes available before common stockholders can receive any dividends.

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9 - Ibid

Holders of non-cumulative preference shares, on the other hand, lose any claim on dividends when not paid by the company regardless of weather or not profits are being earned.

Control to be Sacrificed

With preferred stock financing, control of the firm is not sacrificed. There is, however, the fact that preferred stockholders have some voting rights which are not sufficient to give them control of the company. The voting rights fall into three classes namely permanent, temporary and consent.

The permanent voting right gives the stockholder the perpetual right to participate in corporate activities such as in the election of directors. He may cast his votes either in person or by proxy.

When certain events occur (or fail to occur) temporary voting rights give the stockholder the right to participate in the selection of directors. Such voting rights will continue until the condition that brought them into existence has been remedied.

Consent voting rights are used when certain actions proposed by the Board of Directors

must be approved by the preferred stockholders before the actions may be completed.

Fixed Periodic Payments

A company does not have to make fixed payments to the preferred stockholders, nor can they take any legal action if dividends on preferred stocks are not paid. However, the following three things are considered when making decision regarding dividend payment to preferred stockholders:-

(i) Moral Obligation - the belief by the stockholders that the company will pay dividends if it is prosperous.

(ii) Penalties - imposed on the company after dividends are in default on preferred stock for a certain number of periods. One penalty is that common stockholders cannot receive returns if dividends are not being paid on the preferred stocks.

(iii) Not paying a preferred dividend will depress the price of both the common stock and preferred stock.

Length of Use of Funds

Preferred stock does not have a maturity date. However, in many cases, preferred stock is callable, that is, a company at its option can return the funds to the preferred stockholders. Many issues of preferred stock have a sinking fund where the issuer promises to repurchase some of the preference shares each year.

Collateral

No collateral is pledged. In fact, when preferred stock is sold, the assets available for pledging to creditors actually increase. Preferred stockholders, like common stockholders, own the company, which in turn owns the assets.

Managerial Restrictions

Preferred stock restricts management's freedom to make certain decisions typical of which are the following:-

(i) Limitations on paying dividends to common stockholders when certain financial ratios are unsatisfactory.

(ii) Provisions forbidding the payment of dividends to common stockholders

when sinking fund installments on the preferred stock are in default.

(iii) Limitations on the purchase or redemption of junior securities as long as there is preferred stock outstanding.

(iv) Features of the charter that require the approval of the preferred stockholders before assets can be sold or leased to another company.

(v) Provisions forbidding the issuance of additional securities, particularly bonds, prior preferred stock, and pari-passu preferred stock (i.e. those that rank equal with the preferred issue already outstanding).

Advantages of Preferred Stock

Preferred stock has the following advantages:-

(i) Creditors view preferred stock as equity. Hence, a company can maintain or enhance its equity to debt ratio without diluting the future earnings potentials.

(ii) Preferred stocks allow the company to increase its debt capacity.

Utilization of this debt capacity created by preferred stock financing provides financial leverage and magnifies the return to common stockholders.

(iii) Preferred stocks are useful financial tool in mergers and acquisitions. The owners of the company to be acquired may be more inclined to listen to offers emphasizing income and security over capital appreciation. In these cases preferred stock becomes a desirable vehicle for facilitating the merger.

Disadvantages of Preferred Stock

The disadvantages are:-

(i) Because preferred stock is viewed as more risky than bonds, it carries a higher dividend rate that the coupon rate on a bond issue by the same company.

(ii) Preferred stock dividends cannot be regarded as an expense as is the case with interest payments on bonds.

(iv) Common Stock

Holders of common stocks are the residual claimants on the assets of the firm in the event of bankruptcy and receive dividends only after all payments on debt and preferred stock have been completed. Thus, common stock is the riskiest form of financing, even though it is regarded as the best alternative means for raising long-term finance. Common stock can be evaluated from the point of view of the company by using the set of criteria earlier considered above.

Cost of Funds

A company bargains over the cost of capital when it fixed the price at which it will sell the common shares. While it will prefer to receive a high selling price, the purchaser will prefer to pay a low price. Thus, a relatively high selling price lowers the cost of capital to the company and a relatively low selling price raises the cost of capital to it.

Control to be Sacrificed

As a rule, voting rights must be given to common stockholders. A small firm or a family-owned firm that sells its common shares

to persons other than the present shareholders may cause the loss of the control of the original shareholders on the firm.

Fixed Periodic Payments

A company does not have to make periodic payments for the use of stockholders' funds. If it earns profits, it can decide to pay dividends to the stockholders. The payment of dividend is however not compulsory by the company as it can plough back the profit into its operations.

Length of Use of Funds

Funds committed by common stockholders into a company stay there permanently. The company does not make any promise to return the monies at a specified time. Thus it can use stockholders' money for an unlimited period of time.

Collateral

When common stock is sold, no collateral is pledged by the management. Common stockholders cannot have property pledged for their benefit because they own the firm - not specific assets in it.

Managerial Freedom

An outstanding advantage of common stock is that it places no restrictions on managerial freedom other than those arising from company law and shareholders voting rights.

Types of Common Stock

Common Stocks can be classified with respect to their claim on income and voting power. One class of common stock may have no voting privilege but is entitled to a prior claim to dividends. Another class may have voting rights but has a lower claim to dividends.

Features of Common Stock

Common Stocks have the following features:-

(i) Par Value

The per value of a stock is merely a stated figure in the corporate charter and is of little economic significance. Par values of most stocks are set at fairly low figures relative to their market values.

(ii) Authorized

The corporate charter of a company specifies the number of authorized shares of common stock, that is, the

maximum that the company can issue without amending its charter. A company usually likes to have a certain number of shares that are authorized but unissued. These unissued shares allow for flexibility in granting stock options, pursing mergers, and splitting the stock.

(iii) Issued

This refers to the number of shares that were actually issued or sold to investors.

(iv) Outstanding

This is the number of shares issued that actually are held by the public. The company can buy back part of its issued stock and hold it as treasury stock.

Rights of Common Stockholders

Holders of common stocks have a number of rights some of which are the following:-

(i) Rights to Establish Major Policies

By virtue of their being owners of a company, common stockholders are entitled to elect a board of

directors that will formulate major policies for the company. The board is responsible to them. The board, in turn, selects the management which is vested with the responsibility of day-to-day administration.

(ii) Right to Vote

Each common stockholder is entitled to one vote for each share of stock he owns. With his votes, he can cast them during annual general meetings of the company and where he can not attend such meetings, he is entitled to appoint a proxy, that is, some one to attend on his behalf.

(iii) Rights to Share in the Distribution of Assets

Common stockholders are entitled to share in the earnings of the company only if cash dividends are paid. Similarly, in the event of liquidation of the company, they can, after all creditors have been settled, share the residual assets.

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(iv) Rights to sell their Shares

They have the right to sell their shares and take their monies back. In private companies, common stockholders can only sell their shares to existing shareholders. In public companies, however, shareholders can even sell to new investors.

(v) Rights to examine Company's Records

They are legally entitled to examine the books or records of their company. They have unlimited access to such records as the Audited Accounts, Memorandum and Articles of Association, Register of Members, etc.

Advantages of Common Stock

Common stock has the following advantages:-

1. The company is not committed to making periodic payments as is the case with issuing either preferred stock or bonds.
2. The company is under no obligation to repay the funds made available through common stock financing.
3. Common stock financing provides a viable

vehicle for the investor to participate in the growth of the economy.

Disadvantages of Common Stock

The disadvantages are:-

1. Common stock financing reduces the magnification of return on equity obtained by previous debt financing.
2. Existing stockholders who do not exercise their pre-emptive rights risk losing their proportional control over the company.

## CHAPTER THREE

## The Capital Market (11)

### 3.1 Introduction

This chapter will give the various classifcations of the Capital Market as well as the important institutions which play specialised roles. Other areas to be covered in the chapter are: Capital Market efficiency, price behaviour of shares and security selection.

### 3.2 Classification of the Capital Market

The capital market may be classified into two broad categories namely organised and over-the-counter capital markets. These are explained below.

Organised Capital Markets

Organised capital markets are formal organisations with physical facilities, governing boards, and membership regulations and requirements[10]. Firms whose securities trade on an organised market are called "listed stocks." Examples of organised capital markets are the Nigerian Stock Exchange, The New York Stock Exchange and Pacific Stock Exchange. Only brokers and dealers (collectively better known as exchange members) are allowed to transact on the Exchange. Financial newspapers do report transactions of organised capital markets.

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10 - Iqbal Mathur

Each member of the exchange has numerous clients - some wanting to sell securities, others wanting to purchase them. Bonds, debentures, rights etc may also be traded on the floor of the exchange. Stock exchanges facilitate the transfer of ownership of securities among investors. Security holders' expectations as to the future determine the prices at which they will buy or sell stocks and bonds and other securities.

Advantages of Organised Capital Markets

Organised capital markets have the following advantages:-

(i) A firm must meet listing requirements before its securities can be traded on an organised market. The requirements are designed to safeguard investors' interests.

(ii) Trading information on listed stocks is more quickly and more readily available to investors. The presence of stock specialists allows for more orderly trading which facilitates buying and selling and enhances liquidity.

(iii) Organised markets have certain disclosure requirements that assure investors a minimum amount of information on firms.

(iv) The visibility provided by being listed makes it easier for listed firms to issue new stock.

Disadvantages of Organised Capital Markets

Listing in the organised capital market has the following disadvantages:-

(i) A firm must agree to submit detailed financial reports;

(ii) Must agree to comply to certain regulations;

(iii) Must bear the cost of listing;

(iv) Listing might encourage speculation in the issue;

(v) Might make it possible for outside groups to gain control of the company when the shares are selling at depressed prices.

Over-the-Counter Capital Markets

Securities that are not traded on an organised market are called "unlisted" stocks and are traded over-the-counter. Over-the counter (OTC) markets have no formal organisation. They have minimal membership requirements and trading rules. The OTC market is composed of dealers who "make a market" in unlisted securities and of the brokers who process orders for unlisted stocks by investors.

Dominant positions are built and protected largely by controlling access to information on supply and demand.



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According to Feldman[11], supply and demand in the market change quickly and erratically and that there is no centralised mechanism for disseminating reliable information to market participants.

In the OTC market, most trades are known only by the parties involved - no ticker tape tracks the price and volume of transactions.

Because no dealer sees the full breadth or depth of trading activity, supply and demand levels must be inferred in a piece meal fashion from often ambigous sources - from trades in which the firm is directly involved, from transactions with interdealer brokers, from the bond future market, from tips volunteered by customers, or other market sources.

OTC markets handle both securities already issued and new securities being sold to the public. The OTC market is primarily a negotiated market where buyer and seller haggle over prices before transaction is completed.

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11 - Lynn Feldman and Jack Stephenson. Stay Small or Get Huge: Lessons from Securities Trading article published in Harvard Business Review No. 3 May/June 1988.

Dealers in the OTC market buy securities with the hope of being able to resell them at a higher price. A dealer in OTC can handle a buy order from clients in one of two ways[12]:-

(i) Will sell the securities to his clients from his own inventories; or

(ii) Will immediately get in touch by telephone with other dealers, if he does not own the desired securities, who are likely to have them for sale.

Where a client has securities for sale, the transaction will be handled in one of the following two ways:-

(i) Dealers will buy the securities for their own accounts (inventory), or

(ii) If they do not want them, they will get in touch by telephone with other dealers who are likely to be interested in buying them.

Feldman[13] says that interdealer brokers handle transactions between brokers on a "blind" basis, so that counter-parties cannot be identified until hours or days later when settlement occurs.

According to him, the largest portion of the world's securities trading takes place in the OTC markets.

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12 - Joseph F. Bradley, Administrative Financial Management, fourth Edition published by the Dryden Press, Hinsdale, Illinois 1979.

13 - Ibid

Advantages of OTC

Over-the-counter capital market has the following advantages:-

(i) Some companies trade OTC because they are too small to meet the listing requirements of organised markets;

(ii) Some companies trade OTC because they do not want to divulge financial information required by organised markets;

(iii) Some others prefer to maintain a low profile which they believe is provided by remaining unlisted i.e. on OTC.

Other Classes of Capital Markets

In addition to the two broad categorisation, there are the Third Market and the Fourth Market. Similarly, capital markets can be primary or secondary. These are expalined as follows:-

The Third Capital Market

The Third market refers to over-the-counter trading in listed securities, usually in large blocks. Bradley[14] points out that there is no rule or regulation that forbids the trading of listed securities in the over-the-counter market. It is brokers that actually constitute the market.

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14 - Ibid

Large institutional investors such as mutual funds, life insurance companies, pension funds etc frequently buy or sell securities in this manner, rather than through a stock exchange. The main benefits to this group of buyers and sellers are:-

(i) The commission paid to brokers is lower;

(ii) There is less chance that such large transactions will depress the market price of securities; and

(iii) There is more privacy in the sence that there is no immediate publicity release concerning the transaction.

The Fourth Capital Market

The Fourth Capital Market refers to large institutional investors buying and selling directly with each other, rather than through the OTC or the stock exchange. When large institutional investors bypass all the brokerage machinery, the entire brokerage fee is saved, although there is still a small fee payable to the parties that establish the information system necessary for the operation of the fourth market.

The Primary Capital Market

The Primary Capital Market is a market for new securities. It provides both existing quoted companies and new companies with the faciliity for raising new capital.

For new companies, the primary market operation implies going public via the Stock Exchange. Proceeds from the sale of new securities go directly to the issuing companies which use them to finance expansion and modernisation.

The Secondary Capital Market

The secondary market facilitates the sale of securities by one investor to another. Proceeds of transactions do not go to the firm but to the investor. The market therefore permits holders of existing securities to buy and sell, thus facilitating a change of ownership speedily and preferably at low cost. Smooth functioning of the secondary market aids the primary market by making investors more willing to purchase new securities since they know such can be sold in the secondary market. The secondary market is divided into two namely listed (quoted) securities and OTC securities.

3.3 Institutions of the Capital Market

The capital market is made up of several important institutions. They play specialised roles of varied kinds and importance in the entire capital mobilisation process. The institutions can vary greatly from one national market to another, depending on the sophistication of the market. They can generally be classified according to the functions they perform, viz:-

(i) Those which collect savings;

(ii) Those which obtain funds for borrowers; and

(iii) Those which deal in existing securities.

In most of the under-developed capital markets, one institution can carry out two or more functions. Notable institutions in the capital market include the following:-

Issuing Houses

Issuing Houses are organisations (usually Merchant Banks) which undertake to raise funds on behalf of companies through the issue and sale of securities. They carry out the following tasks:-

(i) Detailed examination about the company and the purpose of raising the funds;

(ii) Assessment of the prevailing financial position;

(iii) Determination of the most suitable type of security to be issued and the applicable terms.

(iv) Preparation of the issue or sale document (prospectus);

(v) Commissioning of any special duties required to be undertaken by experts such as Valuers, Solicitors, Accountants etc.

(vi) Application to the Stock Exchange for listing (where listing is required);

(vii) Whenever applicable, determining the issue/offer price and timing of issue (or otherwise, applying to the Securities and Exchange Commission for these); and

(viii) In some cases, the issuing houses will also put together a buying group or selling syndicate.

Three important services are provided by Issuing Houses and these are:-

(i) Advice

Because of their expertise as specialised financial institutions, Issuing Houses can advise firms against the dangers of say fixing too low or too high an interest rate for a new bond issue.

(ii) Underwriting

Issuing Houses offset the probable dangers of a risk of decline in proceeds from a firm's new bond issues which may come as a result of changes in interest rate in the economy. Underwriting assures the firm of a known amount of net proceeds irrespective of what happens to the market value of the new issue during the distribution period.

(iii) Distribution Channels

Issuing Houses establish appropriate distribution channels to market new securities. Because of their reputation and contacts, they can establish a viable distribution channel that assures the firm of quick distribution of its securities.

Stockbroking firms

These are duly authorised dealers that bring securities into the stock market. They act not only as issuing houses in some cases, but also as brokers to the issues in all cases. Every issue in respect of which a stock exchange listing is sought must be duly sponsored by a stockbroking firm. As agents, they handle public's orders to buy and sell securities. For this service, they are paid commissions.

Commercial and Merchant Banks

Banks operate actively through the provision of direct long term loans and advances to corporate entities. They also act as Issuing Houses and Receiving Bankers in the process of raising equity and debt capital for companies through the capital market. Furthermore, banks act as Registrars to the issues through their Registrars departments and provide immeasurable financial advise to companies wishing to use the capital market for capital raising.

Registrars

Registrars play an important, albeit passive role in the Capital Market by providing share registration services, not only to companies listed on the exchange, but also to private companies. They ensure the payment of dividends, the process of bonus issues as well as the issuance of share certificates, among others. Registrars are usually a subsidiary of Issuing Houses, but they may also be private companies having no direct ownership relationship with any issuing house.

Companies

Companies are major participants in the capital market. Without them, there would be no capital market activity since all deals in the market revolve around companies requiring additional capital for their operations.

Investors

Investors are the ultimate target of all the activities of the various players in the capital market. Without investors, it would not be possible to raise any capital, equity or debt, from any market, be it capital or money market. individual investors expect to make returns on their investment that are higher than what they would have obtained in the money or commodity market. Thus, their primary field is in the equity capital, although they do sometimes invest in debt capital.

Institutional investors, on the other hand, have preference to debt capital subscription, although they sometimes subscribe to equity capital.

Securities and Exchange Commission (SEC)

The Securities and Exchange Commission (SEC) is a regulatory apex body superintending over stock market operations. Its functions include valuation of all eligible securities to determine the price, amount and timing of all public offers of securities. SEC also has the responsibility of registering all eligible securities offered in the capital market. It also registers Stock Exchanges, Issuing Houses, Stockbrokers, Financial Advisors, Fund Managers etc. The Commission also maintains surveillance on the securities market to ensure strict compliance with requirements and just and equitable dealings.

Stock Exchange

A stock exchange is an institution which sees to the efficient allocation of available capital funds to the diverse uses in the economy, and, through its extremely sensitive pricing mechanism, ensures that so much of the total available capital resource is allocated to each firm within each industry as that firm and that industry deserve to have, having regard to their relative contribution to the total societal wealth vis-a-vis other firms or industries.

Stock Exchanges perform several functions the most important of which are the following:-

(i) To provide facilities to the public for the purchase and sale of funds, stocks and shares of any kind and the investment of money; and

(ii) To control the granting of a quotation on The Exchange in respect of funds, shares, stock etc.

3.4 Efficient Capital Market

A market is defined as efficient if transaction prices fully reflect in an unbiased way all relevant information available to market participants at the time. The fundamental ideas behind the theory of efficient markets are that in a free and competitive market such as a stock market the prices of financial assets should reflect all publicly available information and that these prices should adjust very rapidly to new information.

Prices of bond change rapidly with changes in interest rates. Similarly, prices of equities change rapidly in response to changes in the rates at which future dividends are being discounted. Discount rates for equities change in response to alterations in interest rates, risk premiums, and expected cash flows.

In a rational stock market, where investors seek returns commensurate with risk, prices will change rapidly in

response to changes in risk as well as to changes in interest rates and dividend prospect.

The necessary conditions for an efficient capital market are the following:-

(i) Dealing costs should not be too high;

(ii) The relevant information is available to a sufficient number of investors; and

(iii) No individual participant is of sufficient wealth that he can in any sense dominate the market.

There is the efficient market hypothesis which was developed in order to understand the randomness of stock prices. Being an extreme hypothesis, it is tested by postulating some security price behaviour that is implied by market efficiency.

Accordingly, there are three forms of the efficient market hypothesis namely the weak form, the semi-strong form and the strong form and these classifications of market efficiency were given by Fama[15]. Statistical research were carried out and the broad thrust of the results obtained from scores of tests on available data supports the Efficient Market Hypothesis.

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15 - Fama, E.F. "The Behaviour of Stock Market Prices, Journal of Business, 38, 1965

According to Franks[16] et al the University of Chicago had a data base containing monthly share price for all companies listed on the New York and American Stock Exchanges for over 40 years. The data was tested by academics and their sponsors on Wall Street. The results confirmed the Efficient Market Hypothesis. Similarly, early indications from the new London Stock Exchange data base at the London Business School led to the same conclusions.

The Weak-Form Market Efficiency

The weak form of market efficiency states that current prices fully reflect the information implied by the historical sequence of prices. That is historical price and volume data do not contain any information which can be used to earn above average-returns. Thus, share price changes are said to follow a "random walk" in which all future prices represent a random departure from the current price. These deviations from the current price reflect the influence of new information.

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16 - Franks, J.R. & Broyles J.E. Modern Managerial Finance, published by John Wiley & Sons Ltd, 1979.

Therefore, the expected value of the price of a security at the end of any future period is equal to the current price plus any expected return. No additional information is known which is not already incorporated in the current price. Hence, changes in price would be unrelated to past price changes. It was observed by Kendall17 that various U.K economic indices, including shares and commodities, appeared to follow a random series.

The Semi-Strong Form Market Efficiency

The semi-strong form says that current stock prices reflect all publicly available information including, of course, the published accounting information in financial statements and that stock prices adjust rapidly to new information. Corroborating evidences such as dividend increase or improved prospects of the firm can positively affect share price. Similarly, announcements of takeover or merger between two companies affect share price.

17 - Kendall, M.G The Analysis of Economic Time Series Part 1, Journal of the Royal Statistical Society, 116, 1953.

Halpen (1973)[18] and Mandelker (1974)[19] found that in the United States the market began to anticipate the benefits of mergers up to 8 months on average before the merger. In the U.K., Franks, Broyles, and Hecht[20] found that market price began to anticipate mergers at least 3 months before the merger announcement date on average.

The Strong-Form Market Efficiency

The strong form of the efficient market hypothesis asserts that even those who have access to "privileged" information cannot consistently make use of it to produce superior investment results. Thus, it denies the benefit of special or inside information.

3.5 Price Behaviour of Equity Shares

There are three school of thoughts concerning security valuation and the behaviour of security prices. these are:- Technical analysis school, Fundamental analysis school and Efficient Market School. They are explained below:-

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18 - Halpen, P.J Empirical Estimates of the Amount and Distribution of Gains to Companies in Mergers, Journal of Business, 46, 1973.

19 - Mandelker, G. Risk and Return: The Case of Merging Firms, Journal of Financial Economics, 1, 1974.

20 - Franks, J.R, Broyles, J.E, and Hecht, M, An Industry study of Mergers in the United Kingdom, Journal of Finance, 32, 1977.

Technical Analysis School

Technical analysis involves the study of historical price and volume data either for one stock or a group of stocks and deducing the future trend from this analysis. The technicians attempt to predict future price levels by examining the past data from the market itself. To them, the price of a stock depends on supply and demand and has little relationship to intrinsic value. The technicians use a variety of tools such as bar and point-and-figures charts, moving averages and other trend lines, relative strength measures, statistics on new highs and lows etc to assess the strength of supply and demand factors. The fountain head of all technical analysis is the Dow Theory which was developed by Charles H. Dow.

Fundamental Analysis School

This school maintains that at any point in time an individual security has an intrinsic value which should, in principle, be equal to the present value of the future stream of income from that security discounted at an appropriate risk-related rate of interest.

The actual price of a security, therefore, is considered to be a function of a set of anticipated returns and anticipated capitalization rates corresponding to future time period. Prices change as anticipations change which in turn change as a result of new information.

The fundamentalists rely on key economic and financial variables and attempt to estimate the real worth of a security.

Efficient Market School

Also known as random walk, the efficient market school states that price changes cannot be predicted from earlier changes in any "meaningful" manner. Successive price changes (or successive one period returns) in individual securities are independent over time and that its actual price fluctuates randomly about its intrinsic value. At a given point in time the size and direction of the next price change is random with respect to the stock of knowledge available at that point of time and that the "....best predictor of tomorrow's price is today's price." This implies that past history of share prices will not enable an investor to obtain an above-average return.

3.6 SELECTION OF SECURITY

In an evaluation of a particular security, the investor typically considers two main points viz:

(i) The dividends expected over a given period of time; and

(ii) The possibility of capital appreciation or depreciation on his investment.

Following this evaluation, the investor arrives at some idea about the perceived value of the security. Individual's perception about a company can affect the value measurement for its security.

The value of common stock is considerably influenced by the expectations of dividends in the future. The valuation model is:-

$$Po = \frac{D_1}{1+ke} + \frac{D2}{(1+k_e)^n} + \ldots + \frac{D_n}{(1+K_e)} + \ldots$$

Where:

$P_o$ = Value of Common Stock at begining of current period, t = 0

$D_1$ = Current period dividend paid at the end of the period when t = 1

$D_n$ = nth period dividend

g = Compounded growth rate in dividends

ke = Discount rate

The value of a stock is the sum of the present value of all future dividends.

For stocks without any growth, dividends would be constant from one year to the next, that is:

$D = D1 = D_2 = \ldots . Dn = \ldots .$

$$P_0 = \frac{D}{1 + K_e} + \frac{D}{(1+K_e)^2} + \ldots + \frac{D}{(1+K_e)^n}$$

$$= \frac{D}{K_e}$$

With constant growth stocks, it is assumed that dividends payout ratios are stable and constant. The earnings and dividends are growing at a constant compounded growth rate of g%, and that $K_e > g$.

Under this assumption, $D_1$ is equivalent to $D_0 (1+g)$.

Similarly, $D_2 = D_1 (1+g) =$

$D_0(1+g)(1+g) = D_0 (1+g)^2$ . In general,

$$D_n = D_0 (1+g)^n$$

$$P_0 = \frac{D_0 (1+g)}{1+K_e} + \frac{D_0 (1+g)^2}{(1+K_e)^2} + \ldots + \frac{D_0 (1+g)^n}{(1+K_e)^n} + \ldots$$

$$= \frac{D_1}{K_e - g}$$

For management to increase the value of the firm it must understand how the firm is to be valued. One obvious basis for valuation of the firm is the expected returns to investors and associated risks. Unfortunately, however, most firms focus their attention on measures of return and therefore frame their financial strategies accordingly.

Notable measures of return used by such firms are: earnings, earnings per share and price earnings ratio. The returns which investors receive on their investments are in fact two viz dividends and capital gains as already stated above. Thus, returns to shareholders are defined as dividends received and capital gains experienced during a period, expressed as a fraction of the value of the investment at the beginning of the period.

$$\text{Returns} = \frac{\text{Dividends + change in market value}}{\text{Initial Market Value}}$$

If management wishes to benefit shareholders, it must try to maximize the Net Present Value of investments in order to increase dividends and capital gains to shareholders. Expected dividends and capital gains are not the only factors to be considered; there is also risk. Risk is present with every investment decision. Virtually all decisions involve a large element of uncertainty about the future and are taken in the expectation of returns which might not fully materialize or could result in losses.

Whereas statisticians measure risk in terms of variation from the mean or expected return, investors think of risk as the probability of having to take an unacceptable loss.

The statistician's measure of risk which is based on standard deviation can give a good indication of how far actual returns might exceed or fall short of the mean or best estimate. However, for the investor's perception of risk to be closely determined, the probability of loss has to be minimized. For this reason, since minimizing the standard deviation minimizes the probability of loss, the standard deviation (or the standard deviation squared, termed the variance) has generally been regarded as a more useful measure of risk in financial investment.

The economist's view of risk aversion, framed in the context of utility theory, is closely identified with the standard deviation. The early development of the theory of investment portfolios was based on the assumption that investor behaviour can be characterized by those types of utility function for which the standard deviation provides a sufficient measure of risk.

Markowitz suggests an adequate approach to portfolio (and indeed security) selection. The approach is the Expected return - Variance of return theory (E-V). The theory assumes that expected return is desirable and that variance (risk) is undesirable.

The ability of the E-V theory to yield useful results depends upon the ability of the investor to formulate his

probability beliefs concerning the expected return and variance of return precisely.

In evaluating the expected return on a given security, several factors may or may not be considered important by particular investors. Some investors are interested primarily in dividends while others take interest in both dividends and capital appreciation of a security over a period of time. In either case, the investor has some idea of the naira amount he expects to realize over a certain period by investing in a share of a stock. This may easily be converted into an annual rate of (expected) return on the price of the stock.

Another method of computing expected return is to rely on statistical analysis of the past projected into the future. Say, for instance, to predict the per cent annual return from dividends over the next year, past records of prices and dividends can be used to calculate the annual return for each year over a period in the past.

In formulating beliefs about a security's variance of return, the investor again has at his disposal pure judgement and statistical methods. The variance is equivalent to the square of the standard deviation which can be expressed in naira or in per cent expected return and can be readily converted into variance. The variance of returns over a past period can be taken as the

probable variance in the future period. A combination of statistics and good judgement may give acceptable values in the calculation of both expected return and variance of return.

## CHAPTER FOUR

## THE NIGERIAN STOCK EXCHANGE

### 4.1 INTRODUCTION

This chapter intends to give historical background of the Nigerian Stock Exchange, its role in the economy and how it has performed so far. The primary market will come into focus together with the second-tier arm of the stock market. Furthermore, the chapter will look into the variety of financial instruments that are dealt with in the Stock Market as well as the benefits of public quotation to companies. Lastly, the chapter will outline the statutory requirements for listing into the Nigerian Stock Exchange and also talk about the Securities and Exchange Commission (SEC) which is an important regulatory institution in the Nigerian Capital Markets.

### 4.2 Historical Background

The Nigerian Stock Exchange (NSE) is a self regulatory organisation in the Nigerian Capital Market. It was incorporated in September 1960 as a private company limited by guarantee. In 1961, the Exchange, then known as the Lagos Stock Exchange commenced operations with 19 securities worth N80 million[21].

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21 - Memorandum to the Panel on the Review of the Nigerian Capital Market by The Nigerian Stock Exchange.

The Exchange is owned by 310 members made up of financial institutions, stockbrokers and individual Nigerians. The Council of the Exchange is responsible for policy-making while the day-to-day affairs are administered by the Director-General and his team of Executives.

The Exchange presently has six branches located in Lagos (1961), Kaduna (1978), Port Harcourt (1980), Kano (1989), Onisha (1990) and Ibadan (1990). A new branch in Abuja has been approved and should commence business in due course. All the branches function principally as Trading Floors.

Dealing members of the Exchange are stockbroking firms licensed by the Exchange to buy and sell shares on behalf of the investing public. There are 162 of them at the moment.

The securities traded on the Nigerian Stock Exchange are stocks, bonds and managed funds. The trading system being used is the callover trading system. Clearing and settlement is done by the Central Securities Clearing System which is a subsidiary company of the Nigerian Stock Exchange. The Subsidiary company provides a computerized Stock Exchange Management Systems (SEMS) which emphasises immobilization of share certificates in a Central Depository. The system allows for electronic/book-entry transfer of share from seller to buyer and settlement for the securities. All securities transactions will be processed and concluded within five working days (i.e. T+5) in electronic book entry form.

Efforts are being made by the Nigerian Stock Exchange to adopt the AUTOMATED TRADING SYSTEM (ATS) which will enable all market participatns to play the market from any part of the country on real time on-line basis. In 1987, the Exchange became the fourth Stock exchange in the world to be hooked on-line and LIVE to the REUTERS ELECTRONIC CONTRIBUTOR SYSTEMS (ECS) which daily beams its stock market information to the global community. The ECS service provides automated access by foreign investors to relevant information on companies quoted on The Nigerian Stock Exchange. The access code number is NXSA.

4.3 Role of The Exchange in the Economy

The activities of The Stock Exchange have wider implications on the national economy. The Exchange made special arrangements which helped ensure a smooth transfer of ownership from foreign shareholders to Nigerians during the Indigenisation Exercise. Thirteen companies used the facilities of The Exchange to comply with the Indigenisation Act of 1972 while 78 Companies sold over 300 million shares worth over N210 million through it to comply with the Nigerian Enterprises Promotion Act of 1977. In 1989 the Federal Government Privatisation and Commercialisation Programme commenced. By the end of 1993, government has divested from 34 companies through the stock market.

Out of this number, 28 were first timers on the Stock Exchange while the remaining six were previously quoted.

Arising from their privatisation, for instance, the performance of the companies has recorded significant improvement as attested below:[22] -

(i) Turnover and profitability increased dramatically after privatisation. Average profit before tax grew by 400 percent.

(ii) Average cash dividend pay-out showed a post privatisation increase of 363.6 percent.

(iii) Average ratio of dividend payout to profit after tax increased by 64.7 percent for all companies.

(iv) Most of the companies have witnessed at least two-fold increase in their market prices which is an indication of favourable public perception of the companies.

(v) As at 31st December 1996 the privatised companies collectively had a post privatisation market capitalisation of N79 billion as against N4.0 billion at the time of privatisation, indicating a growth of 1875 percent.

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22 - The Stock Exchange and Capital Formation in Nigeria an article by Apostle Hayford Alile, DG NSE published in Vanguard Newspaper edition of Tuesday, September 9, 1997.

The 28 companies which were listed for the first time recorded a post privatisation growth of 1704 percent from a market capitalisation of N2.7 billion at the time of initial offering to N48.7 billion at the end of 1996.

(vi) The debt to equity ratio of many of the companies dropped following privatisation. The relatively low leverage level points to the fact that with access to the capital market and given its benefits, most privatised enterprises now rely more on equity capital as a financing method.

(vii) The privatisation exercise has improved market awareness in the country as the capital market was the preferred vehicle for divestment to ensure widespread shareownership. The level of awareness may be measured by the level of subscription to the offers. Of the 28 new companies privatised, 16 were either fully or over-subscribed.

(viii) Some of the companies have increased their shares through bonus issues, rights issues and public offer for subscription.

Over the years, the Nigerian Stock Exchange has made significant contributions to the capital formation process in Nigeria, both as a vehicle for raising capital and as a catalyst for fund mobilisation efforts.

For instance, between 1961 and 1987, the Federal Government raised long-term funds through its Federal Government Development Stocks worth over N10 billion on The Exchange for on-lending to the regional (and later state) governments for the financing of development projects. Similarly, five state governments and one local government raised various sums of money to finance diverse projects. The states and local government are :- defunct Bendel State (N20 million for housing programme in 1978), Ogun State (N30 million for water project in 1985), Oyo State (N30 million for market development in 1987), Lagos State (N90 million for Lekki new town development in 1987), Kaduna State (N30 million for ginger processing plant in 1993) and Lagos Island Local Government (N100 million for the ultra-modern Sura market project in 1992).[23]

Following the deregulation of interest rates in 1989 and the consequent interest rate crisis in the money market, many companies used the funding opportunity offered by The Exchange to raise various sums of money (through equity and debt instruments) for the financing of plant modernisation and/or expansion of operations. In come cases, quoted companies have resorted to The Exchange to meet their justifiable working capital needs.

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23 - Memorandum to the Panel on the Review of the Nigerian Capital Market by the Nigerian Stock Exchange.

Corporate recognition of The Nigerian Stock Exchange as a source of medium and long-term capital is fully reflected by the sustained growth in the key performance indicators of the market.

4.4 Performance of The Stock Market

The Nigerian Capital Market is one of the few emerging stock markets desperately courted by investors. According to the International Finance Corporation (IFC), the Nigerian Stock Market was as at July 1997 the second highest in the world in terms of total returns which accommodates capital appreciation and accrued dividend paid by quoted stocks.

Between January and June 1996, the turnover in volume was 289 million as against 672 million in the corresponding period of 1997, thus showing an increase of 132.5 percent[24]. Furthermore, the market turnover in value moved by 163.6 percent from N2.2 billion to N5.8 billion. Market capitalisation also moved from N221.4 billion to N390.5 billion within the same period, indicating an increase of 71.8 percent. The index growth increased from 13.8 percent in 1996 to 21.0 percent in 1997.

The table below summarises:-

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24 - Special Survey on Nigerian Capital Market published by Thisday Newspaper, Vol. 3, No. 891 of Monday September 29, 1997.

| | Jan-June 1996 | Jan-June 1997 |
|---|---|---|
| Market Turnover(Vol. | 289 million | 672 million |
| Average Daily Volume | 2.3 million | 5.5 million |
| Market Turnover(Value) | N2.2 billion | N5.8 billion |
| Average Daily Turnover | N17.9 million | N47.5 million |
| Market Capitalisation | N221.4 billion | N390.5 billion |
| Index growth | 13.8% | 21.0% |

In spite of the above, the Stock Market is seen to be highly under-utilised in terms of volume of shares and variety of instruments. Foreign companies constitute about 95 percent of the listed equities securities. About 45 percent of the N390.5 billion market capitalisation is held by foreigners in bloc and not traded upon. About 15-18 percent is held by domestic institutional investors like insurance companies, pension fund, provident fund, endowment funds and so on. They have surplus cash but they still want to buy more without selling the ones they have. So, only about 40 percent of the market capitalisation is available to about 2.6 million individual investors.

4.5 Financial Instruments

In its present form, the Nigerian Capital Market lacks variety. Outside equities, there are no other profitable instruments which investors can play around with. While in other markets, investors talk of warrants, options, debt

securities, corporate bonus, pension funds, in Nigeria fund managers and investors have very restricted basket of instruments to diversify their portfolios.

The government stock market is dormant. The derivatives market is almost non-existent. Bond market is dormant because it is held by institutional investors that are not trading in it. They are statutorily obliged to hold some of these instruments in their portfolio.

The financial instruments used in the Nigerian Capital market are:-

(i) Share floatation.

(ii) Loan stock/debenture stock.

(iii) Debt conversion.

(iv) Mergers/Acquisitions.

Share Flotation

This involves a company inviting members of the public to contribute to its funding and by so doing share in the control and ownership. Monies raised through this means go to the coffer of the company (in the case of offer for subscription) or to the existing member willing to divest of initial shareholding in the business (offer for sale).

Loan Stock/Debenture Stock

A company can borrow long-term finance from the capital market via the sale of loan stock or debenture stock. A debenture/loan stock is an instrument evidencing that the money has been lent to the company at specified rates.

Experience in the past few years has shown that interest rates on debenture/loan stocks still lag behind loan rate.

Debt Conversion

In its desire to reduce its external debt obligations, the Federal Government introduced Debt Conversion whereby interested investors can buy Nigeria's offshore debts for conversion into Naira for equity investment in qualifying projects in Nigeria. Since 1988 this singular source has contributed substantially to foreign investment in this country. The medium through which this transaction is consumated remains the capital market through regulatory bodies as the Central Bank of Nigeria and the Securities and Exchange Commission.

Merger and Acquisitions

Mergers and acquisitions have become an important survival stratergy which have been successfully adopted in the Nigerian Capital Market. A merger is a combination of two or more companies in which all but one of the combining companies legally ceases to exist and the surviving company continues in operation under its original name.

On the other hand, acquisition is the taking over of a business concern by a more resource-based outfit. In this circumstance the ownership and management are brought under the management of a large concern. Both terms are often used interchangeably.

The driving force behind the adoption of this strategy may be either one or a combination of the following motives:-

(i) to gain access to relevant information and technology;

(ii) to increase market share or diversify product lines;

(iii) to ensure a steady source of raw materials;

(iv) to acquire a pool of skilled manpower;

Mergers and acquisitions may be accomplished by pooling of interest or directly using cash. The first method means that the acquiring company simply issues additional shares to the present shareholders of the acquirer while the latter involves outright cash payment for the shares offered for sale.

4.6 The Primary Market

The Primary Capital Market is concerned with the offering of new issues or the initial issuance of securities in The Exchange. For a company not previously quoted, a primary market operation implies going public via The Stock Exchange and if in the process new securities are sold to the public, the proceeds go to the company to finance expansion and modernisation. Quoted companies can also seek expansion funds through the issuance of supplementary securities in the primary market.

Debt and equity securities can be issued in the primary market. The types of debt instruments available on the Nigerian Stock market are:-

(i) Federal Government Development Stocks, and

(ii) Industrial loans, preference Stocks and Bonds.

The potentials of the Nigerian Bond market are grossly under-utilised. While equity market continues to grow at a very fast rate, the bond market is still dormant. Between 1992 and 1996 only 30 new issues were brought to the bond market compared with 75 new issues in the equity market. In value terms, the bond market that accounted for nearly one-third of new issues in 1992 worth N515 million plummetted to a dismal N15 million in 1996 compared with equity market's N4.8 billion[25].

Happenings in the government's bond market revealed government's waning interest in the market. This is confirmed by the fact that 1987 was the last time the Federal Government issued a development stock - when it issued 15.75% N180 million 25th development stock. State governments too have not issued any bond since 1993 when the 2nd Kaduna State bond of N30 million was issued. And 1992 was the last time a local government bond was brought to the market. Only one industrial loan stock each were brought in 1995 and 1996 to the market and this (1996) was valued at mere N15 million.

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25 - Special Survey on Bond Market in Nigeria published by Thisday Newspaper Vol. 3, No. 891 of September 29, 1997.

Issue Procedure

For a company wishing to go to the Stock Market for the first time, there must be a Resolution of its Board of Directors stating the objectives of going public or using the primary market. The resolution is conveyed to an Issuing House which analyses the Report and Accounts of the company to determine whether they are up to the standard prescribed by the Exchange.

In a public issue, a number of parties, including the Issuing House perform various roles. The Issuing House is a financial advisor and is normally a merchant bank. It performs the following important roles to an issue:-

(i) Prepares the necessary documentation in respect of the Offer subject to the company providing all the information and documents that may be considered necessary for the exercise;

(ii) Makes application to the SEC for registration of the Offer subject to the Company paying the appropriate filing and registration fees to the SEC;

(iii) Determines, in conjunction with the company, the price at which the shares will be offered to the Public or the coupon rate in the case of a Debenture Stock;

(iv) Offers the stock or shares to the public, upon the terms and conditions set out in the Prospectus;

(v) Prepares and proposes a basis of allotment to the company;

(vi) Obtains clearance for the basis so determined from the allotment Committee of the SEC.

(vii) Appoints third parties to the Offer with the consent of the company;

(viii) Co-ordinates the functions of third parties;

(ix) Remits the proceeds of the Offer to the Company;

(x) Manages the offer from inception to completion to ensure that share/stock certificates are issued and despatched to those entitled thereto promptly.

(xi) Advises the company and generally assists in actualising the company's objectives.

The Issuing House (or financial advisers) determines the amount required by the company after considering its future plans, cash at hand, credit lines and supplier's terms of credit. All these are utilised in doing a comprehensive financial analysis in which the cash needs of the company are considered. Other key issues like desirable leverage ratios, P/E ratio, interest cover, Asset cover, etc are projected before an adequate financing structure is proposed.

In addition to the SEC, the Stock Exchange and an Issuing House, other parties to a public offer of Equity are:-

(i) Solicitors to the company;

(ii) Solicitors to the offer;

(iii) Reporting Accountants;

(iv) Auditors to the company;

(v) Public Relations Agency;

(vi) Registrars; and

(vii) Printers.

In the case of a Debenture Stock offer, the following parties would be required in addition to the above:

(viii) Trustees; and

(ix) Solicitors to the Trustees.

The Offer documents for a public issue will contain all the relevant information pertaining to the Offer, including the Application Form. These include the following but they differ depending on the type of Offer:

- Prospectus
- Private Placement Memorandum
- Rights Circular

<u>The Prospectus</u>

The prospectus is a selling document made available to the public in respect of the issue being floated. It is what the public relies on to analyse the company with a view to being informed before making investments decisions.

The prospectus contains all the pertinent information about the issue and the issuer such as History of business, purpose

of issue, parties to the issue, financial summary and projections, appropriate excerpts from the Articles and Memorandum of Association, and if it is a debt issue, will contain extracts from the Trust Deed.

Private Placement Memorandum

Where securities are to be sold to a select group, a private placement (also known as direct placement) memorandum is prepared. Like the prospectus, private placement memorandum contains all relevant information necessary in marketing selected individuals and institutional investors. As earlier mentioned, private placement is usually applied to sell the shares or debentures stocks of unquoted companies.

Rights Circular

Rights circulars are notices sent to existing shareholders calling them to exercise a right by subscribing to a predetermined number of new shares in proportion to the number of already issued shares. The circular specifies the amount of new shares, the amount to be paid and the time limit within which payment is to be made.

Subscription

Upon the receipt of approvals from the relevant authorities such as the Nigerian Stock Exchange and Securities and Exchange Commission, the new securities are advertised. The advert is allowed to run for say two weeks before the opening of subscription whose period is normally a maximum of twenty one (21) consecutive days.

Experience has shown that an offer can be concluded within three months of the key documents being ready. Allowing for an additional one month for the return and clearance of up-country cheques, the lead time for the receipt of the proceeds of the Offer will be about four months.

Generally, a company can employ any of the following methods to sell new securities:-

(i) Outright sale to investment bankers;

(ii) Sale through privileged subscriptions;

(iii) Sale through private placement;

(iv) Sale through the use of investment bankers as selling agents; and

(v) Direct sale to individual investors without the aid of investment bankers.

Methods (iii) and (v) are more or less not relevant to the Nigerian Stock Market. The methods are commonly used outside the organized capital market. For the purpose of this research, we will restrict ourselves to the other methods.

Outright Sale to Investment Bankers

The Investment banker (an Issuing House such as Merchant bank) acts as an intermediary in the distribution of new securities. In doing this, the investment banker provides three important services viz: advice, under-writing and distribution.

A company after having specified the amount to be raised can invite an investment banker to provide such amount. In this

case, the company sells the entire issue to the investment banker who in turn sells to the general public.

The difference between the price (amount) paid to the company and the selling price to the public is known as the spread and it constitutes profits or losses to the under-writer. An advantage of this method is that a company is assured of a fixed sum of cash.

Sale through Privileged Subscriptions

This mode of sale of new issues has already been explained in 4.026 above.

Sale through the use of Investment Bankers as Selling Agents

If investment bankers are used as selling agents, the amount of cash to be received by the company is not definite but depends on the number of securities sold by the investment bankers. For each unit of the security sold, the investment banker receives a commission.

4.7 The Second-Tier Securities Market (SSM)

The Indigenisation exercises of 1972 and 1977 compelled eligible businesses to sell varying proportions of ownership shares to Nigerians. Soon, the number of industrial securities that were publicly quoted rose to some 92 equities and 25 debt. Out of this number, only 3 were wholly-owned Nigerian companies.

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At a seminar on public quotation for indigenous companies organized by The Nigerian Stock Exchange in Port-Harcourt in 1981, the following reasons were given as to why indigenous

companies shunned quotation at the Stock Exchange:-

(a) High cost of seeking quotation;

(b) Fear of losing control of the business upon obtaining quotation;

(c) Egocentric reasons (personal convictions);

(d) Reluctance to disclose accurate financial information; and

(e) Little or no knowledge of the capital market.

Consequently, NSE having considered these factors, relaxed the listing requirements in order to provide a platform for small/medium scale businesses to have access to a pool of investible funds by seeking quotation. There is no gainsaying that the future of any country lies in the steady growth and development of small/medium sized businesses, because it is this category of businesses that generate faster opportunities for economic growth and employment. Thus, the Second-tier Securities Market was established in 1985 in order to attract small/medium enterprises which form the bulk of indigenous companies to the stock market. Twenty-nine out of the listed securities on the Nigerian Stock Exchange Market are equities offered by small and medium scale enterprises (SMEs) through the Second-Tier Securities Market (SSM). Eight of these companies have since graduated to the Main Market (First-tier), having used the facilities of the market to finance their evolution into large scale industrial concerns.

By establishing the Second-tier market, the Nigerian Stock Exchange and Securities & Exchange Commission gave adequate recognition to the need for small and medium sized companies to become big. The listing requirements were specifically tailored to suit indigenous companies without necessarily losing the need for high standard and integrity in business.

Case Study

Tripple Gee's Experience

Historical Background

Tripple Gee started as a one-man business in 1977. Shortly after, another shareholder was brought in who eventually happened to be the company's financier. Tripple Gee had some rough time and the shareholder - financier proposed that the company should be liquidated. The company borrowed money from a bank and due to delay in obtaining payment from customers, the bank threatened to appoint a Receiver for the company. The promoter, with 51% controlling equity, stalked the liquidation bid proposed by his shareholder-financier and decided to seek funds from the capital market. By 1991, Tripple Gee got listed on the Second-Tier Stock Exchange. Between that time and now, it has been rapid growth for the company.

Post Listing Performance

Tripple Gee's performance is given below:-

| | Pre-listing (1990) | Post-listing (1995) |
|---|---|---|
| | N'M | N'M |
| Paid-up Capital | 1 | 18 |
| Reserve | 0.9 | 42 |
| Turnover | 10.7 | 190.4 |
| Profit After Tax | 0.5 | 18.6 |

The paid-up capital rose by 1700 percent while the reserve increased by 4567 percent. Turnover and profit after tax appreciated by 1679% and 3620% respectively.

Tripple Gee is adjudged as very stable, very strong and growing. The company can boast of seasoned professional managers and the value for the company's stocks are immediately known because of its getting listed.

4.8 Listing Requirements

Listing is an admission into the official list of The Exchange. For companies to get listed (or quoted) they must satisfy the following requirements:-

First-Tier Market (Main)

1. Company must be registered as Public Limited Liability;
2. Must submit to The Exchange Financial statements/business record of past 5 years.
3. Date of last audited account must not be more than 9 months.

4. Amount of money that can be raised is unlimited depending on the borrowing power of the Director/Company;
5. Annual quotation fees based on market capitalization;
6. At least 25% or N250,000 nominal value of share capital must be offered to the public;
7. Number of shareholders must not be less than 300;
8. After listing, company must submit quarterly, half-yearly and Annual Accounts;
9. Securities must be fully paid-up at the time of allotment;
10. Unalloted securities must be sold on NSE Trading Floors; and
11. Provision for issue of mergers, acquisitions, unit trusts and mutual funds.

Second-Tier Market (SSM)

1. Company must be registered as Public Limited Company;
2. Must submit to The Exchange financial statements/business record of past 3 years. (However, new companies may be considered);
3. Date of last Audited Accounts must not be more than 9 months;
4. Amount of money that can be raised may not exceed N5 million;
5. Annual Quotation fee is a flat rate of N3,000.00;

6. At least 10% of the nominal value of share capital or N50,000 must be offered to the public;
7. Number of shareholders must not be less than 100;
8. After listing, company must submit half-yearly and Annual Accounts;
9. Securities must be fully paid-up at time of allotment;
10. Unalloted securities must be sold on NSE Trading Floors;
11. No provisions for Issue of mergers, acquisitions, unit trusts and mutual funds yet.

4.9 Advantages of Public Quotation

Through the benefits derivable from going public have earlier been mentioned elsewhere, it is however worthwhile to bring them again here. They are as follows:-

1. The company will have access to larger capital either as equity or loan that can be used for expansion and modernization.
2. The shares of the company become more easily transferable, since it will be listed on the Daily Official List of the Exchange.
3. The company's shares are more valuable to the shareholders as they become more acceptable as collateral for bank loans since the quoted price is generally available for the valuation of the shares.

4. The company's credit rating,. and respectability improves significantly.

5. Share options, a direct benefit to management employees, tends to motivate staff in a company listed on The Exchange. Eventually, quality personnel are attracted.

6. Companies quoted on The Exchange are continuously advertised, free of charge, on the Daily Official List, Newspapers, T.V. Business News and Reuters international network.

Economics/Cost of Issue

The Stock market has a comparative advantage over other sources of finance in the provision of long-term funds. This is enhanced by the following economies:-

(i) The mechanism for raising the funds are efficient and they operate in a near perfect market;

(ii) There is the tendency for higher charges by the banking sector especially the commercial banks when financing long-term capital. This is because of their short-term funding orientation.

(iii) Usually the amounts raised on long-term basis are higher than what a single bank can safely provide a client. To reduce the risk, syndication is resorted to and this invariably increases the cost of issue.

With regard to the cost of issue, experience has shown that there is an inverse relationship between the cost of issue and the value of the issue. The percentage reduces as the value of issue increases leading to a falling average cost per unit of issue. Some fees are standard while others are negotiable. The following fees are standard:-

1. The Nigerian Stock Exchange
   - Listing Fees (Graduated according to the amount being raised)
   - Application/Processing Fee (1% of amount being raised)
2. The Securities and Exchange Commission
   - Application Fee - N5,000
   - Filing fee of the prospectus - N10,000
   - Registration Fee (1.5% of amount being raised)
3. Brokerage to Receiving Banks and Stockbrokers (1% of amount being raised)

The fees that are negotiable are the following:-

1. Issuing House Fee (2.5% of amount being raised but negotiable)

2. Brokers Fees (0.5% of amount being raised)

3. Fees to Professional parties.

4. Registrars' Fees.

5. Printing Costs.

6. Public Relations/Advertising Costs.

4.10 The Securities and Exchange Commission

Historical Background

Following the recommendations of the Okigbo Committee on the Review of the Nigerian Financial System, the Federal Government set up the Securities and Exchange Commission (SEC) in 1978. The enabling Decree was the Securities and Exchange Commission Decree (No. 71) of 1979. The functions of SEC among others are:-

(i) Determining the amount of, and time at which securities of a company are to be sold to the public either through offer for sale or subscription.

(ii) Registering all securities proposed to be offered for sale to, or for subscription by, the public or to be offered privately with the intention that the securities shall be held ultimately other than by those whom the offers were made.

(iii) Maintaining surveillance over securities market to ensure orderly, fair and equitable dealing in securities.

(iv) Registering stock exchange or branches, registrars, investment advisers, securities dealers and their agents and controlling and supervising their activities with a view to maintaining proper standards of conduct and professionalism in the securities business.

(v) Protecting the integrity of the securities market against any abuses arising from the practice of inside trading.

(vi) Acting as regulatory apex organization for The Nigerian Stock Exchange and its branches to which it would be at liberty to delegate powers.

(vii) Creating the necessary atmosphere for the orderly growth and development of the capital market.

(viii) Undertaking such other activities as are necessary or expedient for giving full effect to the provisions of this Decree.

Responsibility for Pricing

A lot of criticism was generated by SEC's responsibility to fix price for new issues. Critics pointed out that where companies fear that they may not get a fair price for their new issues, they would not seek a stock exchange listing. The more objectionable aspect of the SEC's price fixing role actually related to the detail mechanics of price determination.

The task of determining a share's price is not a straight forward thing. Rather, it is an intelligent estimation with the help of some quantitative and non quantifiable factors. SEC used to demand for information that would make possible the determination of a realistic price for the share. The information cover the following matters:-

1. Audited Accounts for 5 years immediately preceding the issue or sale;
2. Brief history of the business including particulars of products dealt with;
3. Capital structure and changes in this over the years;
4. Particulars of top management;
5. Major features of the Memorandum and Articles of Association;
6. Pending litigations, if any;
7. Assets, especially landed property and plant;
8. Future developments; and
9. Major contracts entered into affecting the business in material terms, etc.

Following the deregulation of the Capital Market in 1992, the pricing of new issues became the responsibility of both the Issuing House and the Issuer. The current practice is one in which the Issuing House prepares a Pricing Memorandum containing the valuation techniques considered appropriate with some plausible assumptions. The price arrived at by the

Issuing House is discussed with the Issuer whose agreement or concurrence has to be obtained. The mutually agreed price is then attached to the ordinary shares to be sold. This price is communicated to SEC, however, for information purposes only, along with the other details of the issue.

Pricing for Initial Public Offers

The two commonly used valuation methods recommended by SEC when it had approval powers over pricing are still widely employed by the Issuing Houses for initial Public Offers. The methods are: Assets Approach and Earnings Approach. The results obtained from the two methods are compared and a price is determined after taking into consideration factors such as:-

i) The present state of the business and future prospects;

ii) The likelihood of continuity of those factors that contributed to past success (e.g. management, supply arrangements, access to technological development;

iii) Nature of the company's product and its susceptibility to competition, change in taste, change in government policy or general economic conditions.

The two methods are explained below:-

KASHIM IBRAHIM LIBRARY

The Net Assets Approach

This approach looks at the Net Assets (excluding fictitious and intangible assets such as goodwill, formation expenses, advertising and publicity expenses not yet written off) which are then divided by the number of shares in issue as at a particular balance sheet date should give the price of its ordinary shares.

In the attached appendix, this approach gives a price of N5.55 per share for the ordinary shares of Company ABC. This method is considered more relevant in the valuation of the ordinary shares of a company that is about to change ownership, merge or for valuing banks.

The Maintainable Earnings Approach

This approach takes the mean of the profit after tax (PAT) for a company for the last five years. This mean (average) figure is then discounted using a rate of return peculiar to the sector to which the company belongs. The discounted figure is then divided by the outstanding shares of the company as at a particular balance sheet date to arrive at the value of the ordinary shares of the company. This method is useful for valuation on a going concern basis. The existing rates of return recommended by SEC, by sector are:-

| | Sector | | Capitalization Rate |
|---|---|---|---|
| (i) | Agro-Allied Industries | - | 10-12.5% |
| (ii) | Property | - | 12.5-15% |

| | | | |
|---|---|---|---|
| (iii) | Banking/Finance | - | 15-17.5% |
| (iv) | Manufacturing | - | 17.5-20% |
| (v) | Commercial | - | 20-25% |
| (vi) | Services | - | 25-30% |

From the appendix, the average price of ABC's share is N1.31. From the two methods and after considering certain factors, a market price of N3.30 per share was arrived.

Pricing of Already Quoted Companies

Some already quoted companies access the capital market for the purpose of raising funds for diversification or expansion purposes. Such companies have established stock market prices attached to their shares which then constitute reference points for the determination of their prices at each point in time when they want to raise fresh funds. The existing market price is not wholly adopted when an already quoted company is desirous of raising fresh funds. A discount element is normally considered which constitutes an incentive to both the existing and prospective shareholders of the company. The discounted price enhances the marketability of the shares of the company and it is, therefore, in the overall interest of both the Issuer and the Issuing House.

The main question, however, is the extent of discount to be granted.

In determining the extent of discount, it is normally useful to compare the prices of the ordinary shares of the company's competitors within the industrial categorization to which they belong. The discount element must not be so large as to connote cheapness in terms of the price of the Issuer. In general, however, the following factors are known to influence the discount element:-

1. The position of existing shareholders.
2. Underwriting.
3. Existence of willing block shareholders.

Pricing of Debt Instruments

The market for debt instruments in Nigeria has been on a steady decline and a situation has now been attained whereby debt instruments are resisted by the market. This is so because the pricing of debt instruments has not kept pace with the realities of the economy. The Minimum Rediscount Rate (MRR) of the Central Bank has always been used as the fulcrum of the pricing process for debt instruments. Floaters and especially, premiums that have always been added to the MRR and other sweeteners have not succeeded in motivating investors to the extent that almost all the debt offerings the capital market has seen in recent times have ended up being heavily undersubscribed.

Between the late 1980s and the early 1990s there was a vibrant money market with mouth-watering rates on short -term funds and investors were only ready to put their investible funds in money market instruments to the detriment of long-tenored schemes like debenture stocks. To reverse the situation, shot term rates must be pushed below coupon rates for debenture stocks and other debt instruments in order for borrowers to access the capital market for cheap funds for development purposes.

Registration for Securities

Since 1978, the responsibility for the registration of securities was vested with SEC. Prior to that date, it was the Registrar of Companies that used to handle the registration.

ABC NIGERIA PLC

Appendix

Share Price Computation

A. Maintainable Annual Profit Method

| Year | Profit/Loss After Tax N'000 |
|---|---|
| 1991 | 10,359 |
| 1992 | 22,304 |
| 1993 | 39,019 |
| 1994 | 35,785 |
| 1995 | 108,303 |
| | 215,770 |
| Average Maintainable Profit | 43,154 |
| No. of issued and fully paid ordinary shares of 50k each as at 30/6/95 | 176,596,000 |

(i) Capitalization at 17.5%

Average Maintainable profit $\frac{43,154,000}{0.175}$ - 246,594,286

Per Share Value $\frac{246,594,286}{176,596,000}$ - 1.40

(ii) Capitalization at 20% $\frac{43,154,000}{0.200}$ - 215,770,000

Per Share Value $\frac{215,770,000}{176,596,000}$ - 1.22

Average Value per 50k shares - 1.31

| | | | | |
|---|---|---|---|---|
| C. | Net Assets Basis | | | |
| | Net Assets as at 30/6/95 | 979,969,000 | | |
| | No. of ordinary shares | 176,596,000 | | |
| | Net Assets per share | | - | 5.55 |
| C. | Market price as at 30/6/95 | | - | 330k |

# CHAPTER FIVE

## 5.00 DATA PRESENTATION, ANALYSIS AND HYPOTHESES TESTING

### 5.01 INTRODUCTION

Eight out of the seventy-two unquoted companies were selected for this study. The selection was done based on certain considerations which include acute shortage of funds being faced by the companies and the prospects they have in the future if provided with adequate and cheap funds.

The Chapter is divided into three sections variously dealing with data presentation, data analysis and hypotheses testing.

### 5.02 Data Presentation

For purposes of concealing the true identities of the companies, code symbols have been used. All the information provided in respect of the companies is obtained from their audited accounts accept, of course, the operational problems. Efforts have been made to analyse the performances of the companies for the past five years and latest available audited accounts (at the researcher's disposal only) were used. The summary of the findings is presented below:-

NO 1: (Audited Accounts as at 31st December 1995)

| | | |
|---|---|---|
| Authorized Capital | : | N1.400 million |
| Issued & fully paid | : | N1.343 million |
| Capital Reserves | : | N68.744 million |
| Profit & Loss Account | : | (N1.746 million) |
| Shareholders' funds | : | N68.341 million |
| Indebtedness | : | Not indebted, apart from liabilities incurred in the normal cause of business. |
| Performance | : | In the first four years turnover progressively increased before it declined in the fifth year. The company recorded losses in 4 of the 5 years of the review period. |
| Dividend Payment History | : | Because of the poor performance, no dividends were declared in the period. |
| Earnings per share | : | Recorded earnings per share of 85 kobo in the 3rd year. |

| | | |
|---|---|---|
| Dividends per share | : | Nil |
| P/E ratio | : | Nil |
| Dividend yield | : | Nil |
| Dividend cover | : | Nil |
| Operational Problems | : | o Inadequate working capital.<br>o Dilapidated Machinery.<br>o inefficient management. |
| Future Prospects | : | The company seems to have good future only if the problems are overcome. |

NO 2: (Audited Accounts as at 31st December 1995)

| | | |
|---|---|---|
| Authorized Capital | : | N200,000 |
| Issued & fully paid | : | N200,000 |
| Profit & Loss Account | : | (N1,340,403) |
| Shareholders' funds | : | (N1,140,403) |
| Indebtedness . . . | : | Not indebted, other than liabilities incurred in the cause of normal business. |

| | | |
|---|---|---|
| Performance | : | The first three years witnessed growth in turnover culminating into a drastic fall in the fifth year. Losses and profits were intermittently recorded. |
| Dividend Payment History | : | No dividends were declared in the period. |
| Earnings per share | : | Earnings per share of 13 kobo and 63 kobo were recorded in the period. |
| Dividends per share | : | Nil |
| P/E ratio | : | Nil |
| Dividend yield | : | Nil |
| Dividend cover | : | Nil |
| Operational problems | : | o inadequate working capital.<br>o inefficient management.<br>o stiff competition. |
| Future Prospects | : | The future is assured provided the problems are solved. |

NO 3: (Audited Accounts as at 31st December 1996)

| | | |
|---|---|---|
| Authorized Capital | : | N10,000,000 |
| Issued & fully paid | : | N8,625,000 |
| Capital Reserves | : | N5,463,345 |
| Profit & Loss Account | : | (N7,093,814) |
| Shareholders' funds | : | N6,994,531 |
| Performance | : | Turnover recorded increasing growth in the first four years and sharply dropped in the fifth. The company recorded losses in the first two years but the fortunes reversed in the third and fourth years when marginal profits were recorded. |
| Dividend Payment History | : | No dividends were declared in the period. |
| Earnings per share | : | Earnings per share of 4 kobo was recorded in the fourth year. |
| Dividends per share | : | Nil |
| P/E ratio | : | Nil |
| Dividend yield | : | Nil |
| Dividend cover | : | Nil |

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| | | |
|---|---|---|
| Operational problems | : | o inefficient management.<br>o stoppage of rehabilitation/expansion programme.<br>o inadequate working capital.<br>o shortage of manual workers. |
| Future Prospects | : | The company enjoys near monopoly as such its future is prosperous if the problems are addressed. |

NO 4: (Audited Accounts as at 31st March 1993)

| | | |
|---|---|---|
| Authorized Capital | : | N25,000,000 |
| Issued & fully paid | : | N7,000,000 |
| Profit & Loss Account | : | (N7,660,760) |
| Shareholders' funds | : | (N660,760) |
| Indebtedness | : | The company was indebted to the tune of N16.6 million. |
| Performance | : | The company has stopped operations in 1994. However, its performance in the three years |

| | | |
|---|---|---|
| | | preceding the stoppage indicates that turnover recorded marginal increase in the second year but remained stagnant in the third year. No profit was recorded within the three-year period. |
| Dividend Payment History | : | No dividends were declared owing to poor performance. |
| Earnings per share | : | Nil. |
| Dividends per share | : | Nil |
| P/E ratio | : | Nil |
| Dividend yield | : | Nil |
| Dividend cover | : | Nil |
| Operational problems | : | o inefficient management.<br>o non-competitive pricing.<br>o inadequate working capital. |
| Future Prospects | : | The future can be bright if the problems are solved. |

NO 5: (Audited Accounts as at 31st December, 1993)

| | | |
|---|---|---|
| Authorized Capital | : | N10.0 million |
| Issued & fully paid | : | N7.358 million |
| Profit & Loss Account | : | (N10.582 million) |
| Shareholders' funds | : | (N3.025 million) |
| Indebtedness | : | Indebted to the tune of N1.613 million as at 31/12/95. |
| Performance | : | The performance was characterized by intermittent rise and fall in turnover within the five-year review period. The company recorded losses throughout. |
| Dividend Payment History | : | No dividends were declared owing to poor performance. |
| Earnings per share | : | Nil. |
| Dividends per share | : | Nil |
| P/E ratio | : | Nil |
| Dividend yield | : | Nil |
| Dividend cover | : | Nil |

| | | |
|---|---|---|
| Operational problems | : | o inefficient management.<br>o inadequate working capital.<br>o poor marketing strategies.<br>o broken down equipment. |
| Future Prospects | : | With the existence of abundant raw materials and high demand for the company's products, its future is deemed bright if the problems are solved. |

NO 6: (Audited Accounts as at 31st March, 1995)

| | | |
|---|---|---|
| Authorized Capital | : | N10.0 million |
| Issued & fully paid | : | N9.519 million |
| Capital Reserves | : | N165.750 million |
| General Reserve | : | N1.321 million |
| Profit & Loss Account | : | (N45.270 million) |
| Shareholders' funds | : | N131.321 million |
| Indebtedness | : | Nil. |
| Performance | : | Turnover declined in year 2 of the review period but picked up remarkably in year 3 and remained static in year 4. The company recorded substantial losses throughout the review period. |
| Dividend Payment History | : | No dividends were declared owing to poor performance. |
| Earnings per share | : | Nil. |
| Dividends per share | : | Nil |
| P/E ratio | : | Nil |
| Dividend yield | : | Nil |
| Dividend cover | : | Nil |
| Operational problem | : | o inadequate working |

| | | |
|---|---|---|
| | | capital. |
| | | o dilapidated machines. |
| | | o high import contents of raw materials. |
| Future Prospects | : | Once the problems are addressed, the future is guaranteed. |

NO 7: (Audited Accounts as at 31st December, 1996)

| | | |
|---|---|---|
| Authorized Capital | : | N10.0 million |
| Issued & fully paid | : | N10.0 million |
| Assets Valuation reserve | : | N14.781 million |
| Profit & Loss Account | : | (N131.373 million) |
| Shareholders' funds | : | (N106.592 million) |
| Indebtedness | : | N49.157 million. |
| Performance | : | Turnover increased in the 2nd year but declined sharply in the 3rd year. It picked up appreciably in the 4th year and then dropped remarkably. In the last two years of the review period, the company recorded huge losses. |

| | | |
|---|---|---|
| Dividend Payment History | : | Dividends were declared in the first and second years of the review period. |
| Earnings per share | : | The company's earnings per share dropped from 53 kobo in the first year to 11 kobo in the second year and 8 kobo in the third year of the review period. |
| Dividends per share | : | Dividend per share also declined from 31 kobo to 10 kobo. |
| P/E ratio | : | price/earnings ratio increased from 4.3 to 16.3 and 21.5 in the review period. |
| Dividend yield | : | Dividend yield decreased from 13.7% to 5.5%. |
| Dividend cover | : | Dividend cover dropped from 1.7 times to 1.1 times. |
| Operational problems | : | o inefficient management. |

| | | |
|---|---|---|
| | | o inadequate working capital.<br>o over-dependence on imported raw materials.<br>o inadequate marketing. |
| Future Prospects | : | The future holds prospects provided the problems are overcome. |

NO 8: (Audited Accounts as at 31st December, 1994)

| | | |
|---|---|---|
| Authorized Capital | : | N10.0 million |
| Issued & fully paid | : | N8.5 million |
| Capital Reserves | : | N11.313 million |
| Profit & Loss Account | : | (N16.736 million) |
| Shareholders' funds | : | N3.078 million |
| Performance | : | There was a remarkable increase in turnover each year in the first three years of the review period. In the fourth year, turnover declined but appreciated remarkably in the fifth year. Despite all this, the company recorded |

| | | |
|---|---|---|
| | | losses consecutively for four years. |
| Dividend Payment History | : | No dividends were declared owing to poor performance. |
| Earnings per share | : | Nil. |
| Dividends per share | : | Nil |
| P/E ratio | : | Nil |
| Dividend yield | : | Nil |
| Dividend cover | : | Nil |
| Operational problems | : | inefficient management.<br>o inadequate working capital.<br>o huge debt burden. |
| Future Prospects | : | The future is considered prosperous if the problems are properly addressed. |

5.03 Analysis

In this section, the data presented in 5.02 above will be analysed with investors interest in mind. As we saw earlier, investors when looking for securities to buy are typically concerned about dividends expectation and the possibility that their capital will appreciate over time.

i) Dividend declaration

| frequency (times) | 0 | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|---|
| No. of projects | 7 | - | 1 | - | - | - |

Only one company declared dividends in the review period.

The company declared dividends twice. The remaining seven companies did not declare due largely to poor performance.

ii) Dividend per share (K)

The dividend per share paid within the period by the only company declined by 60% between the first and second declarations. The decline was attributable to low performance. However, the payout ratio had increased from 58.9% to 89.9%. The company paid 31 kobo and 10 kobo respectively in the first and second declarations.

Dividend per share represents the amount that is paid on the par value of share as profit. Investors are very much interested in the amount.

iii) Dividend yield (%)

Dividend yield is the return an investor receives on his investment relative to the amount he has

paid. The dividend yield dropped from 13.7% to 5.5%.

iv) Dividend Cover (times)

Dividend cover from the two declarations decreased from 1.7 times to 1.1 times. Dividend cover measures how many times dividend per share is covered by earnings per share.

v) Earnings per Share (K)

Only four companies recorded positive earnings per share. While two of them recorded only once, one other recorded twice and another recorded up to thrice. The earnings per share increased from 13 kobo to 63 kobo in the company that recorded twice because of improvement in profit. However, the earnings per share in respect of the company that recorded thrice increasingly reduced first from 53 kobo to 11 kobo and finally to 8 kobo.

vi) Price/Earnings Ratio

The price/earnings ratio is used to estimate the value of firms. The ratio tells how much an investor is willing to pay for a company's prospects of earnings. The higher the ratio the more an investor is being asked to pay for the profits he is buying. The ratio was computed for four companies but it is so small in the case of three out of the four that the researcher considers



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negligible. However, the ratio increased from 4.3 to 16.3 and 21.6 in the case of the fourth company. The company was found to have posted very low profits. Therefore, the seemingly increasing high price/earnings ratios could only mean that profits are expected to recover in the future.

vii) Operational Problems

It has been observed that certain operational problems have adversely affected the performances of the companies. The table below shows the nature of such problems and their frequency of occurrence amongst the companies:-

| Project | Operational Problems | | | | |
|---|---|---|---|---|---|
| | Inadequate Working Capital | Inefficient Management | Dilapidated facilities | loan burden | Others |
| 1 | | | - | - | |
| 2 | | | - | - | |
| 3 | | | | - | - |
| 4 | | | - | | |
| 5 | | | | - | |
| 6 | | - | | - | |
| 7 | | | | - | |
| 8 | | | - | | - |

As can be seen, the prime problems are inadequate working capital, inefficient management, dilapidated facilities and loan burden. However, the study also identified other

problems such as stiff competition, non-competitive pricing, poor marketing, high import contents of raw materials and stoppage of rehabilitation works due to shortage of funds. These are grouped under "others."

From the statistics above, the distribution of the operational problems is as shown below:-

| Nature of problem | No. of projects affected | % |
|---|---|---|
| i) Inadequate working capital | 8 | 100.0 |
| ii) Inefficient management | 7 | 87.5 |
| iii) Others | 6 | 75.0 |
| iv) Dilapidated facilities | 3 | 37.5 |
| v) Loan burden | 2 | 25.0 |

It is clear that inadequate working capital is the largest single operational problem as all the companies are besieged by it. Inefficient management is the second largest single predominant problem.

The analysis further indicates that four companies are each affected by two key problems and another four projects each by three key problems. This is in addition to some mild problems grouped as "others" as explained above.

| No. of key problems | No. of projects affected | % |
|---|---|---|
| 1 | 0 | 0 |
| 2 | 4 | 50 |
| 3 | 4 | 50 |
| | 8 | 100 |

5.04 Hypotheses

Hypothesis No. 1

"Existing shareholders will not put additional finance because returns on their investments are not encouraging."

We saw in section 5.03 that only one company out of the eight studied declared dividends in the five-year review period. It has been further observed that in the last ten years, no dividends were declared by four companies. While two of them could not declare dividends because they recorded losses throughout the 10 years, the remaining two had not declared despite the fact that they recorded profits in some of the years. Similarly, the performance of two others in the last 8 years shows that while one of them posted losses in 7 of the 8 years the other declared dividends 5 times within the 8 years.

In spite of the above, however, the study has found out that 6 of the 8 companies have increased their paid-up share capital recently through rights issues with varying degrees of responses from their shareholders. The amounts of the rights

issues involved and shareholders' responses are shown below:-

| Project | Rights Issue (N'M) | Remarks |
|---|---|---|
| 1 | 20.0 | Shareholders' response very encouraging. |
| 2 | 40.0 | Very encouraging. |
| 3 | 8.6 | No shareholder has made any response. |
| 4 | 13.2 | Two out of eight shareholders have already paid their respective portions. |
| 5 | 10.0 | Most shareholders have paid for their allotments. |
| 6 | 4.8 | No call has been made yet. |
| 7 | nil | nil |
| 8 | nil | nil |

From the table it can be seen that responses have been most encouraging in three companies while there is good attempt in another. There is no any attempt from the shareholders of another. The sixth company has indeed not made any call. Upon further analysis, it has been observed that certain considerations were the underlying reasons why shareholders positively responded to the rights issues. The considerations include recent changes in the management of some of the projects, existence of ready markets for products, possibility

of going for export, abundance of raw materials locally and the agreement by a lender to reschedule the payment of an outstanding loan over a fairly reasonable time. All these considerations are pointers that the companies have good future.

From the foregoing, therefore, one can say that the shareholders are not necessarily concerned with dividends before making additional investments in companies, but rather, they are concerned about the future earnings of such companies.

Hypothesis No. 2

"The companies poor performance coupled with the stringent conditions of banks make borrowing difficult."

The study has discovered that three of the eight companies are indebted to some banks. An examination of some loan agreements revealed that the terms and conditions vary from one transaction to another. The summary of the underlying terms and conditions is presented below:-

| Facility | Amount (N) | Tenor | Interest Rate | Repayment | Other Conditions |
|---|---|---|---|---|---|
| 1. Overdraft | 5.0 m | - | 3% over prime lending rate (then at 21%) | on demand | interest is payable monthly on arrears; interest rate is subject to fluctuation as it is governed by the money market. |
| 2. Overdraft | 64.0 m | 12mths | " | 4 quarterly installments of N16.0 m | " |

Furthermore, a bank when approached by a company for an additional facility of N21.0 million demanded as a condition precedent to drawing down on the loan that the company provide the following:-

i) N10 million for refurbishing of its machinery;

ii) N1.138 million appraisal fee;

iii) N2.849 million adjustable legal fee;

iv) N10.0 million for the importation of an essential raw material; and

v) Security mortgage in addition to the factory worth N10 million.

It was only after the conditions were met by the company that the bank would provide as follows:-

i) N10 million working capital;

ii) Convert its existing loan facility (over N30 million) into term loan payable over 5 year period with 1 year moratorium.

The table below shows the outstanding bank facilities against the three indebted companies and the interest charges paid at the end of their respective financial years.

| | Project 1 | Project 2 | Project 3 |
|---|---|---|---|
| Facility Outstanding | | | |
| i) Loan | N1.459 m | N16.600 m | Nil. |
| ii) Overdraft | N22.581 m | N3.305 m | N24.632 m |
| Interest Paid | | | |
| i) Loan | N0.015 m | N1.231 m | Nil |
| ii) Overdraft | N4.411 m | N0.411 m | N3.949 m |
| Interest as % of amount outstanding: | | | |
| i) Loan | 1.0% | 7.4% | Nil |
| ii) Overdraft | 19.5% | 12.4% | 16.0% |

The loans and overdrafts were secured by either a charge on company's land and buildings or by a mortgage debenture over fixed assets.

All the three indebted companies recorded losses at the end of their financial years in review. This made repayment and servicing of the loans impossible. Consequently, the loans grow through accrued interest and this is detrimental to business survival.

From this, therefore, it can be said that though the terms and conditions of bank borrowings may appear stringent, the underlying factor for companies' ability to borrow from banks lies with how well they are performing in order to be able to service and repay the loan facilities.

Hypothesis No. 3

"The companies can raise cheap funds from the Stock Market."

As at the time of this study, companies wishing to get listed on the Nigerian Stock Exchange must satisfy the requirements set out in section 4.8 (i.e. listing requirements) of this work. The requirements are examined below:-

i) Company must be Registered as Public Limited Liability

All the eight projects studied are currently private. They will require a Special Board resolution to change their status from private to public. Thereafter they will apply for re-registration with the Corporate Affairs Commission. When applying, the companies are required to provide the following:-

a) Evidence that at least 25% of the authorized share capital has been paid;

b) A copy of their balance sheet as at the date of the special resolution or the preceding 6 months, whichever is later; and

c) Evidence showing that their net assets are not less than the aggregate of the paid-up share capital and undistributable reserves.

The table below shows how the eight companies fair in respect of the above requirements:-

| | Companies | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | |
| Authorized Capital | 10.0m | 10.0m | 10.0m | 1.4m | 0.2m | 25.0m | 10.0m | 10.0 |
| Issued/Paid capital | 8.6m | 9.5m | 7.3m | 1.3m | 0.2m | 7.0m | 10.0m | 8.5m |
| As % of Authorized | 86% | 95% | 73% | 93% | 100% | 28% | 100% | 85% |
| Net Assets | 6.9m | 131.0m | (3.0m) | 68.3m | (1.1m) | (0.7m) | (106.5m) | 3. |
| Shareholders funds | 6.9m | 131.0m | (3.0m) | 68.3m | (1.1m) | (0.7m) | (106.5m) | 3. |

As can be seen, the ratio of paid-up capital to the authorised of all the eight companies exceeded the 25% minimum. Furthermore, the companies net assets equalled shareholders' funds.

ii) Company must submit financial statements for 5 years

The companies studied have been in existence for upward of at least 12 years. They have been found to have audited their accounts fairly promptly. The table below shows the available latest audited accounts at the disposal of this researcher:-

| Year | 1993 | 1994 | 1995 | 1996 | 1997 |
|---|---|---|---|---|---|
| Project | 1 | Nil | 3 | 4 | 0 |

The 1996 audited accounts of four companies have already been perused by the researcher. The companies, financial years end on 31st of December. Perhaps this explains why the 1997 accounts have not been possibly audited yet. For three other companies, the latest available audited accounts are in respect of the year 1995. The three have their financial year ending 31st March every year. One other company's available audited accounts is for the year ended 31st March 1993.

Therefore, from the table above it can be said that half of the companies can satisfy this important requirement immediately while the other half will have to brace up to bring the audited accounts up to date.

iii) Date of last Audited accounts must not be more than 9 months

Suppose a decision is to be taken now for the companies to go public via the Stock Exchange, all the eight companies in this study cannot qualify on the basis of this requirement because the least period between the date of the last audited accounts and the present time is 14 months. The longest period is however 57 months.

iv) Amount of money that can be raised

This requirement will not be hard to fulfil by the companies because all they will need to do is to pass a resolution pertaining to the borrowing power of the Companies/Directors.

v) Annual Quotation Fees

The quotation fees for the First-Tier market are based on market capitalization while a flat rate is charged for the Second-Tier Market.

Quotation fees will unlikely hinder the companies from going public as they can arrange to settle the fees with the parties concerned at more appropriate time.

vi) Amount of Shares that must be offered to the Public

At least 10% or N50,000 nominal value of share capital (in the case of Second-Tier Market) and 25% or N250,000 nominal value of share capital (for First-Tier Market) must be offered to the public. This therefore means that up to 90% of the original shareholders of a company wishing to get listed on the Second-Tier Market and up to 75% of the original shareholders (in the case of First-Tier) can remain in their companies. This requirement can be met by all the eight companies.

vii) Number of Shareholders

It is required that for companies to be listed on the First-Tier Market, they must have not less than 300 members (or shareholders). In the case of the Second-Tier, however, they must have at least 100 shareholders. At the moment, none of the eight projects satisfy this requirement.

The table below shows the distribution of their members.

| Project | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|---|---|---|---|---|---|---|---|---|
| No. of Shareholders | 8 | 4 | 4 | 4 | 7 | 8 | 19 | 8 |

Most of the shareholders are institutional and they hold majority shareholding in each of the companies. It is therefore envisaged that there will be little or no resistance in the companies towards enlarging the ownership base to meet the minimum stipulated.

viii) Submission of quarterly, Half yearly and Annual Accounts

It is required that after listing, companies must submit quarterly, half-yearly and annual accounts. This requirement can be met by all the eight companies once they are listed.

ix) Securities must be fully Paid-up

Securities must be fully paid-up at the time of allotment. Considering that the companies are believed to have good future prospects, the tendency is for underwriters to buy up the shares on issue and this will guarantee instant cash payment to the companies.

x) Unalloted Securities to be sold on NSE Trading Floors

Unalloted securities must be sold on the Stock Exchange trading floors. This requirement can be met by the eight companies. From the analysis of the listing requirements above, it is observed that the companies studied can virtually satisfy them. The requirements are not seen to be stringent as far as the NNDC associate companies are concerned.

# CHAPTER SIX

## 6.00 SUMMARY, CONCLUSION AND RECOMMENDATIONS

### 6.01 Summary

This study is an attempt to find out the eligibility of some of the NNDC associate/subsidiary companies to raise funds from the Capital Market for the purpose of financing working capital requirement and capital works such as expansion and rehabilitation.

The Nigerian Capital Market has been found to provide its clients with many and varied instruments notably debt (debenture and bond), leasing, preference stock, and equity. Each of these instruments has types, features, advantages, and disadvantages.

The study discovered the various classifications of the Capital Market into organized, over-the-counter, third market, fourth market, primary market and secondary market. The organized Capital Market is the most popular and has formal organizations. Stock Exchanges such as the New York Stock Exchange and the Nigerian Stock Exchange fall under the organized Capital Market.

Because the Nigerian Stock Exchange is an organized Market, it is governed by certain rules and regulations. Companies wishing to have access to the market are required to fulfil or satisfy some listing conditions.

There are eleven (11) of such conditions currently. It has been found out that all the eight NNDC companies studied could meet the requirements and thus become eligible for listing on the Nigerian Stock Exchange.

Notwithstanding the above, however, for the companies to successfully raise capital from the market, a lot has to be done with regards to their performances. The study has discovered that virtually all, except one, of the companies had not performed well through out the review period of five years. They posted losses most of the time and were besieged by multitude of operational problems that range from inadequate working capital, inefficient management, dilapidated facilities to debt burden, in addition to other problems.

As investors are concerned with dividends and capital appreciation, they will naturally be attracted by the shares of performing companies, those companies with good future prospects. Fortunately, the study has found out that almost all the eight companies have good future prospects provided that their financial predicaments are properly addressed. And their going to the Capital Market will no doubt help in addressing the non financial problems as well.

## 6.02 Conclusion

Having considered the size and complexity of the eight companies in the NNDC group, it is felt that some are ripe enough to be taken to the Stock Exchange for quotation so as to enable them take advantage of Capital Market for raising relatively cheaper funds by way of any of the available instruments.

The instruments which abound in the Nigerian Capital Market are mainly equity, debenture and bonds. However, NNDC companies could adopt the earlier mentioned two instruments. Funds can be raised from the Capital Market through offer for subscription (equity and debenture stock), offer for sale, private placements, rights issue and bond issue.

The advantages which companies will derive from getting listed on the Nigerian Stock Exchange include having access to larger capital either as equity or loan, their shares become more easily transferable, also the shares become more acceptable as collateral for bank loans since the quoted price is generally available for the valuation of the shares and finally the companies' credit rating and respectability improves significantly.

6.03 Recommendations

It is a fact that investors will be willing to part with their savings as long as the inviting companies appear properly managed and hold out prospects of good returns. Based on the findings of this study, the following recommendations are made:-

1. Those NNDC unquoted companies that are facing serious financial problem but have good future prospects should be encouraged to go public via the Stock Exchange.
2. Prior to their getting listed, however, the problem of inefficient management which has affected a number of the companies should be first addressed.
3. The listing should take place as soon as the performances of the companies improve, as improvement of performance will attract investors.
4. The companies should get listed first in the Second-Tier Market because the requirements there are softer than those in the First-Tier Market.
5. The companies should issue equity only for now because of the advantage that no any statutory payment is required to be made to equity holders, unlike debenture, bond or even preference shares.

6. As for the companies that are not considered ripe for the Stock Exchange, the option of private placement may be considered. In this case, their shares could be marketed to selected individuals and institutional investors.

7 Performing NNDC unquoted projects should also be encouraged to go public. The Stock Market is known for promoting corporate financial discipline, accountability and transparency. As such, the companies will benefit immensely. Other advantages which NNDC companies will gain by getting listed include solvency, efficiency and competitiveness. The companies' leverage position will improve as they can reduce their over-reliance on debt financing by issuing more equity.

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# QUESTIONNAIRE FOR AN MBA PROJECT

Dear Sir/Madam,

As part of the requirements for the award of masters degree in Business Administration from ABU, students are required to undertake a research in a chosen area of interest. Accordingly, I have decided to write on the topic: SOURCING FUNDS FROM THE CAPITAL MARKETS: - A SURVEY OF THE ELIGIBILITY OF NNDC NON-QUOTED PROJECTS. In view of this, I wish to crave for your indulgence to kindly respond to the few questions set out below so as to enable me have a successful work.

Thank you for the anticipated co-operation.

Mahmud Ahmed
Investment Supervision Department
NNDC Ltd
11th June, 1997

1. Financial resource is fundamental to business growth. What would you say about the adequacy of this resource in respect of the non-quoted NNDC investments for which you are a desk officer and or a nominee director?

_____

_____

2. What is the current issued share capital and its percentage to the authorized share capital?

_____

_____

3. Which of the company's major operational problems (if any) can be directly attributed to shortage of funds?

_____

_____

4. How would you assess the success of Rights issues in raising additional funds by the companies?

5. Which are the commonest sources of raising funds by the companies?

6. Will the fear of loss of control by present shareholders or disclosing secret information to competitors or even the fear of full disclosure of financial positions to tax authorities as are entertained in certain quarters prevent the non-quoted NNDC companies from getting listed?

7. If not, what then in your opinion are those things that will likely affect the successful transition of the companies to the capital market?

8. Which of the following capital market instruments viz: Equity, Preference Shares and Debentures would you recommend should your company decides to go public and why?

9. Do you have any comments to make in respect of the subject matter?