INSTRUMENTS OF BUSINESS FINANCE

MEANING OF INSTRUMENTS OF BUSINESS FINANCE

Instruments of business finance, also called financial instrument, is a physical or electronic document that has intrinsic monetary value or transfers value. For example, cash is a financial instrument.

Listed and unlisted securities, loans, insurance policies, interests in a partnership, and precious metals are also financial instruments. A contractual obligation is also a financial instrument as a deed that records home ownership.

SOURCES OF FUND FOR BUSINESS

Funding is the act of providing resources, usually in the form of money (financing), or other values such as effort or time (Sweat equity), for a project, a person, a business or any other private or public institutions. The process of soliciting and gathering fund is known as **Fund Raising.**

Funding such as donations, subsidies and grants that have no direct requirement for return of investments are called “**Soft Funding**” or “**Crowd funding**”. Funding that facilitates the exchange of equity ownership in a company for capital investment via online funding is known as “**Hyper funding**”. Funds can be allocated for either short-term or long-term purposes.

The sources of funds for business are as follows:

1. **Credit**: This refers to a situation where certain institutions like banks give loans or credit to customers for business purposes.
2. **Donations**: Business entities can recant funds from individuals, government and non-governmental organizations for business set-up or expansion.
3. **Grants**: Local or foreign organizations and government can give grants to business set-ups for service or product delivery to the people.
4. **Savings:** Business set-ups can equally get fund through personal savings or company profits for either reinvestments or expansion.
5. **Subsidies**: Government or other organizations may give subsidies to companies. These are materials given in kind or at reduced prices to enable investors have access to the fund for production of goods and services.
6. **Taxes:** Taxes generated by the government can be extended to potential investors for the provision of essential goods and services for the people.
7. **Shares**: Shares can be described as the unit of capital of a company allocated to individuals. It is the interest of the shareholders in a company measured by a sum of money. They are issued by quoted companies and are traded on the stock exchange market.
8. **Bonds:** Bonds are securities issued by the government as a way of raising fund from the stock exchange market.
9. **Stock:** Stock is a collection of shares into a bundle or consolidated shares.

10. **Debentures:** Debentures are loans of long-term nature. A debenture represents a tax document which acknowledges the indebtedness of a company. They are secured on the assets of the company. In addition to raising capital by the issue of shares, a company may also borrow by the issue of debentures. It has a fixed rate of interest.

RAISING OF CAPITAL

The methods by which a company raises capital or issue its shares are:

1. **By prospectus**: A prospectus, giving particulars of the company and its business, is published with an application form. Shares are allotted to those who apply.
2. **By offer for sale**: The whole issue of shares is allotted to an issuing house (merchant bank, finance house) which offers them to the public by means of a document known as "offer for sale."
3. **By placing**: This is the method of issuing securities through an intermediary such as a firm of stock brokers. The intermediary will endeavour to place the issue among its institutional investors.
4. **By a right issue**: When a company is established, it may raise further capital by offering the shares concerned to existing members on favourable terms.
5. **By introduction**: The company concerned can apply to the stock exchange for sales of its shares. There will be an offer to the public of a new issue of shares through the stock exchange.

TYPES OF CAPITAL

There are different types of capital available to a company. These include:

1. **Issued capital**: This represents the part of the authorised capital given out to members of the public for subscription. It is after the issued capital is fully subscribed that it can now be referred to as subscribed capital.

2. **Reserved capital**: This represents the portion of the capital not called up, which the directors have assumed to be incapable of being called up any time. The uncalled-up capital is a liability to the company and is set aside for future expansion.

3. **Authorized capital**: This is also called nominal or registered capital. This is the highest amount of capital stipulated in the memorandum of association considered as enough to set up and run a company.

4. **Called-up capital:** This is the portion of the capital which the management considers good enough to be called up on the issued shares.

STOCK

Stocks can be defined as a bundle of shares or mass of capital which be transferred in fractional amounts. Stocks always fully paid. For example, stocks can quoted per $100 nominal value. It is a collection of shares into a bundle. Stocks are not issued but converted from shares issued.

Differences Between Shares and Stock

Shares	Stocks
Unit of capital is transferable only in their entirety	Mass of capital, any of which is transferable
Shares are issued	Stocks are converted from shares issued
They are numbered serially	Stocks are not numbered serially
Shares may be partly paid	Stocks are always fully paid.

DEBENTURES

A debenture may be defined as a bond, acknowledging a loan, generally under the company's seal and bearing a fixed rate interest. It is usually given security for the repayment of the loan and the payment of the interest. In other words, a debenture is a document setting out the terms of a loan to company, i.e. a certificate of indebtedness. Holders of debentures cannot share from the profit of the company. The Company Act defines debenture as "A written acknowledgement of indebtedness by the Company, setting out the terms and conditions of the indebtedness, and includes debenture stock, bonds and any other securities of a company, whether constituting charge on the assets of the company or not."

Types of Debenture

1. **Mortgage debentures**: Mortgage debentures are issued on the security of the company's assets. It gives a charge upon the whole or part of the company's assets upon liquidation.

2. **Simple or naked debentures**: Where there is no charge created on the company's property or assets, the debenture is described as naked or simple. In this case, there is no security for the debenture.
3. **Secured debenture**: Secured debenture is the type whose repayment is guaranteed through a collateral security tendered by the borrower.
4. **Redeemable debenture**: Redeemable debenture is repayable at a date which has been fixed or determined. A company may issue debentures which are liable to be redeemed.
5. **Irredeemable debenture**: Irredeemable debenture is repayable only in the event of some specified contingency, such as winding up of the company. It cannot be cashed at any time and it is bought solely for interest payments.

PROBLEMS OF BUSINESS FINANCE IN NIGERIA.

Potential investors or companies normally have problems of sourcing fund for their business. These problems are:

1. **Interest rates**: Interest rate is the rate at which farmers can borrow money from bank, i.e. the amount of interest a farmer will have to pay on the money borrowed. A high interest

rate discourages borrowing while low interest rate encourages borrowing. Therefore, farmers cannot borrow when the interest rate is too high.

2. **Collateral security**: This is what the banks and other financial institutions will want a borrower to present before a loan can be given. Such securities include landed property, buildings, etc. Most farmers do not have these securities and, therefore, cannot borrow money.
3. **Long gestation period of some crops**: Some crops like rubber, cocoa and oil palm take a very long time to mature. Banks, therefore, find it very difficult to grant loans to farmers engaged in the cultivation of such crops.
4. **Unpredictable climate which can lead to crop failure**: Agricultural activities in Nigeria depend naturally on rainfall. A good rainfall encourages productivity but lack of rainfall is a doom to farming activities. Banks, therefore, are always afraid to lend money to farmers because unfavourable climate can lead to crop failure.
5. **Lack of farm records**: Farmers lack good farm records of all their activities which can be used to assess their creditworthiness.
6. **High level of loan defaulters**: Farmers may not be able to repay the principal, let alone the interest charged, in case of natural disaster.
7. **Lack of insurance policy**: Farmers do not take insurance policy on their farms.
8. **Lack of moratorium**: Banks do not give moratorium or deferment of payment of loans to farmers.
9. **Land tenure system**: The prevalent land tenure system works against procurement of agricultural loans.
10. **Small farm holdings**: Farm holdings are too small and uneconomical to operate for mechanization and profit.
11. **Lack of awareness**: As a result of the high level of illiteracy among farmers, they are hardly aware of the existence of loan facilities in banks.
12. **Bureaucracy**: Bureaucracy (red-tapism), which is normally involved in the procurement of loans, does lead to non-disbursement of loans to farmers.

REVISION QUESTIONS

1. Define (a) Instrument of business finance (b) Funding (c) Sweat equity (d) Financing (e) Soft funding.
2. Define shares and describe the types, know.
3. Discuss the sources of fund for buying in Nigeria.
4. (a) Write short notes on stock. (b) Differentiate between shares and store.
5. (a) Define stock. (b) How can a company raise or issue its shares? (c) List the type of capital you know.
6. (a) Define debenture. (b) Discuss types of debentures. (c) Different between debenture and shares.

SS1 ECONOMICS NOTE FOR 3RD TERM

TOPIC: INSTRUMENT OF BUSINESS FINANCE