NATIONAL OPEN UNIVERSITY OF NIGERIA

SCHOOL OF BUSINESS AND HUMAN RESOURCE MANAGEMENT

COURSE CODE: BHM 302

COURSE TITLE: BUSINESS FINANCE II

COURSE GUIDE

BHM 302 BUSINESS FINANCE II

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INTRODUCTION

Business Finance is one of the core courses which carry two credits. This course has been carefully prepared purposely to meet the desire of students in this Department and made available to all the students who are undergraduates of Entrepreneurship in the School of Business and Human Resources Management. This course material is very important and valid in your academic pursuit in its entire ramification particularly as Business inclined students.

THE COURSE CONTENTS

This course is made up of three modules and each of the modules consists of units. Module 1 has five units as its subset, module 2 has five units, and module 3 consists of five units. In each of this unit, we discussed the stages in which business can be financed. Module 1 in its entirety discusses the concepts, definition, finance relationship with other departments of the organization, etc. Module 2 looks at the procedure for raising fund, definition of capital and its formation, types and management of capital and Resources acquisition and use. The third module discusses the definition of the term financial resources, its management, what are banks credits, types and the significance of these credits to the growth of a firm.

The course guide serves as a synopsis of the entire course content, the needed materials for the course, and how best you can utilize the materials which serves as a lead way to your success in your programme. The course guide directs you on how you can make the best use of your time and where you could find information necessary to attempt your Tutor-marked assignments which most be turned in to your facilitator form grading. The facilitator will take you on tutorial session particularly in those grey areas that need some additional explanation. Students are advised to form study groups and exchange ideas with their fellow students which is very paramount.

COURSE AIMS

The aim to this course is to expose you to the different types of businesses, mode of raising funds, and how dividend or profits of the business could be shared. How finances are important in running both profit oriented and non-profit oriented businesses. The aims of the course will be achieved, if the following are made:

Explaining the concepts of business

Describing the mechanism and mode of raising funds to manage businesses.

Identify and explain the types of capital

Explain the need for prudency in finance management

Describing how finance is important in businesses and its relationship with other units of the organization.

Explaining the corporate objectives, and how the conflict amongst shareholders, management, and the society can be resolved.

COURSE OBJECTIVES

It is hopped that at the end of this course you should have gathered enough knowledge to be able to:

Identify the different sources of finance in businesses

Analyze the concept of business financing

Discuss the types of capital, its formation

Explain the styles of managing finances in businesses

Analyze the relationship of finance and the different units of an organization

Discuss how the different conflict interests of the shareholders, society, and management of the organization can be equated.

COURSE MATERIALS

The major components of the course are:

1. Course Guide
2. Study Units
3. Textbooks
4. Assignments Guide

STUDY UNITS

The course is subdivided into fourteen units of three (3) Modules for easy study. These are as follows:

MODULE 1

Unit 1 Basic concepts, Principles and Application of business finance

Unit 2 Introduction of finance by definition

Unit 3 The relationship between finance department and other units of An organization

Unit 4 Finance department, its operations and the overall management of corporation

Unit 5 The types, sources and the application of funds. (short, medium, & long term).

MODULE 2

Unit 1 The procedure of sourcing/raising funds

Unit 2 The definition of capital and its formation

Unit 3 Types of capital, fixed and circulating/liquid capital

Unit 4 The measurement of capital.

Unit 5 The acquisition and use of Resources.

MODULE 3

Unit 1 The definition of the term finance resources

Unit 2 The management of financial resources

Unit 3 What are banks' credits?

Unit 4 The types of bank credits

Unit 5 The significance of the bank credits to the growth of a firm.

You are advised to take at least two hours to study each Unit of a module. In this study, you are to consider the introduction, objectives, main content, self assessment exercises, tutor-marked assignments, summary, conclusion, and references/ further readings. In some of the exercises you may need to consult some textbooks to see or get some added information to aid you in tackling the assignments. Apart from the textbooks recommended as part of the further readings, you could also consult some other relevant textbooks and materials. The self-assessment exercises are not asked for fun, but for you to practice them and approach your facilitator to help you grade them. This is the only way you would be able to achieve the objectives of this course.

ASSIGNMNT

The assignments in this course are to help you practice and get yourself acquainted with what you have studied or learnt in previously. Attempt these assignments and turn them in to your facilitator for grading.

TUTOR-MARKED ASSIGNMENT

The tutor-marked assignments are drawn from what you have learnt in the unit. The tutor-marked assignment formed part of your final grading of examination. It carries 30% of the 100% as your final grading.

FINAL EXAMINATION AND GRADING

You are expected to score 100% in the final analysis, however, your examination will be grading over 70% which will be added to the tutor-marked assignment of 30%, this emphases the importance of the tutor-marked assignment in this course.

SUMMARY

The course, Business finance II (ENT 222) has exposed you to how business finance can be run to achieve the corporate objective, management, and the society's. It is expected that once you are done with this course, you would have been well equipped to tackle any question on how business finance can be best managed.

MAIN COURSE

ENT 222: BUSINESS FINANCE II

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MODULE 1

Unit 1 Basic concepts, Principles and application of Business finance.

Unit 2 Introduction to finance by definitions

Unit 3 The relationship between finance department and other units of an organization

Unit 4 Finance department, its operations and the overall management of a corporation.

Unit 5 The types, sources and the application of funds, (short, medium and long) terms

UNIT 1 THE BASIC CONCEPTS, PRINCIPLES, AND APPLICATION OF BUSINESS FINANCE.

CONTENTS

1.0 INTRODUCTION

When you are running a business whether one-man or partnership, it is important that you ensure that the business does not run out of money before it is able to deliver its products or services to the final consumers. According to Heller (2002), “In managing a company or project, it is vital to ensure that it does not run out of money before it was time to sell its products or services and receive payment”.

Finances are the main life-line of any business. In the absent of money, business can not be sustained. Therefore, the source of a continuous flow of money needs to be established for a business to survive.

2.0 OBJECTIVES

At the end of this Unit, you should be able to explain.

why business needs continuous flow of money
how money can be sourced
how cost and gain from business can be shared
and other ways of raising money for business.

3.0 MAIN CONTENT

3.1 THE NEED FOR ADEQUATE FINANCES

For any business to start, it needs some working tools. For instance, a woman who wants to sell fish, she needs a table, knife, cold-room and weighing scales with which to work. These items mentioned are referred to as capital (that is if the business wishes to retain them for more than one year), and therefore, a decision has to be taken whether to buy or lease them. If they are bought then they are referred to as capital for the business. The money needed for the day-to-day running of the business is also called working capital. To lease or buy, this is determined by the cost of the capital, if it is cheaper to lease than to buy, then it will be advisable to lease rather than buy. The cost of stocks of fish (the inventory) that is the amount of fish which she needs to keep should be calculated along side with the running cost of the business for the days or weeks before her customers could come to buy or pay.

In financing a business, it is always advisable to know how much money the owners can put into the business, how much can be borrowed from the banks or other financiers. For sustainability, the general rule in business is to:

Use long- term finances to finance long-term investments
Short-term finances (overdraft, short term loans) to finance short-term investments.
Short-term finances should not be used to finance long term investments.

SELF ASSESSMENT EXERCISE 1

Identify the two different ways to finance a business.

3.2 SOURCES OF FINANCE

People seem to look out for banks as the only source of finance, any businessman or woman should shop throughout the financial window markets. There are financial opportunities other than commercial banks. For instance;

Building Societies
Merchant Banks
Mortgage Finances
Cooperative Societies

Businessmen are always afraid to patronize some of these venture capitalists because they often request for high percentages of interest on the loans or have shares of the company. However, it is more business-like to take such risk by giving say 60 per cent of your business rather than owned 100 per cent of the business that will never be implemented or financed.

It is not always possible to get something from nothing. When you use finance houses, their representatives will wish to maximize their own profit from the relationship with your business. Even in the banks you go to, the banks' employees you deal with may be dressed in customer-friendly titles like Manager, Business Manager, and Marketing Manager, are employed to maximize profit for the banks and not for your businesses. Therefore, you need to give up something to be able to get something in place, which is what business is all about.

3.3 SECURING LOANS

Loans are amount of finances which a business obtained from someone who is not a co-owner of the business to be paid back on a specified period of time. Lenders of funds do always require some securities which are often called (collateral) to safeguard their funds. These collaterals could be in form of the following;

Certificate of Occupancy (C of O) for a house, Land, Company etc.
Share Certificate of a reputable company.
Personal Assets like cars, Jewelries etc
Letter of set-off (you have a savings Account with say three million and you need say five million, the three million will be used as a collateral. Therefore you will be allowed to take a loan of five million, but you will not withdraw from the three million until the five million is fully repaid).

3.3.1 LOANS FROM FRIENDS RLATIONS

This type of loan might be cheaper, collateral free, and at times interest free, but are difficult to come by. This is a mutual understanding between friends to assist one another with finances to run their business with a stipulated time of pay-back. At times these loans are never paid back by the friends. The risk of bad debt here might be very high and sometime it could result to court case. With the understanding, interest payment might be deferred or waved depending on their closeness.

3.3.2 LOANS FROM COMMERCIAL BANKS

The loans here are quite different from the loans from friends. The interest charge will always be higher and the 'loanee' needs to provide collateral as security for the amount so loaned and are for a specified period. The banks loans are saved and secured for both the 'loanees' and loaners. In the case of the bank, interest payments are not to be defaulted or deferred. Interests are paid as at when due, while the principal sum are also deducted along side the interest.

3.3.3 CONTRIBUTION BY THE OWNERS OF THE BUSINESS

These are more or less equities than loans; the business owners contribute their quarters in form of either money or other forms of assets to start the business. The amount so contributed can not be repaid by anybody except in an event of liquidation of the business. Under this, nobody charges interest, but rather profits and losses of the business are shared amongst the owners. In event of liquidation, the contributors only loose their shareholding in the company, but not their personal belongings that is in the case of a limited liability only.

SELF ASSESSMENT EXERCISE 2

1. Discuss the different types of securities that could be offered for a loan in the banks?
2. Mention and explain the three different ways that funds could be raised to start or finance a business.

3.4 SHARING THE COST OF A BUSINESS

In sharing the cost of a business, first of all you have to identify the type of business, is it a One-man, Partnership, or Public Liability Company. It is at this point that you can now know how the cost of the business could be shared. You should be aware that in a one-man business, the cost of the business can not be shared with anybody except you have to look for a loan or raise the fund yourself or through other means. While in the other types (Partnership and Public Liability Company), you could approach your shareholders to raise funds for either expansion or you ask them to finance a new project. Since shareholders are interested in the increase in their share dividends, they usually require that their company is worth a lot more as a result of completing a news project. In the case of a Public Liability Company, fresh shares could be sold to the public through the issuing of an Initial Public Offer (IPO) where people could subscribe to the offer and through it funds are raised to expand the company, or the existing shares can be traded on the floor of the Stock Exchange Market.

3.4.1 SHARING OF PROFITS

The profits of businesses are shared based on the amount of capital contributed to the business. You should know that Managers or Chief Executives of companies do not share in the profits of the company, but receive their wages for managing the businesses. If the investment is a one-man business, then the profits can not be shared.

3.4.2 SHARING OF LOSSES

In the case of losses, the shareholders take their part of the lost according to the ratio of their contribution to the business. Thus, event when the business falls-up, they are only liable to the tune or amount they contributed in starting the business. The liability of the business has nothing to do with their persons or their personal properties. It is only in the case of a one-man business that the owner has to be liable to the extent of his personal belongings.

SELF ASSESSMENT EXERCISE 3

1. Explain the ways the cost of business can be shared.
2. Identify the ways of sharing profits of a business.
3. Describe the sharing of losses in businesses other than one-man business.

3.5 OTHER METHODS OF RAISING FINANCES

Ways of raising finances may not be limited to the above mentioned. There are many financial instruments (ways of raising finance), to run a business, in fact, the most important thing is your ability to negotiate for these finances. If you have a strong negotiating power, you might get cheaper funds, sometimes free of interest, but most times such loan may be converted into shares for the lenders.

Whatever form of finance is negotiated, there is always a cost and often a repayment to be made. The most profitable, cost-effective and satisfying method is to self-finance growth through performance, (try to grow along as the business progresses). In the whole, whatever form of decision you take whether for huge organization or simple investment of your own, if you think that the risk is worth taken, you can go ahead. However, the end is what is important here, that is, there should be success or growth of the business.

4.0 SUMMARY

This unit highlighted the concept of finance in business, the need for a continuous flow of finance to sustain business. The unit also gives the different ways of sourcing for finance and how loans can be obtained and where to obtain it. The sharing of cost of business, profits and lost were also highlighted in this unit and other methods of financing businesses whether huge or simple investment.

5.0 CONCLUSION

The above analyses show that finance is the cornerstone of any business and it needs to be sustained for one to remain in business. Therefore, is very important that businesses should ensure appropriate means of financing these businesses such that growth will be sustained. The need for virile sources of finance is that, it is the life-line of any business and the ultimate of all business investors.

6.0 TUTOR-MARKED ASSIGNMENT.

1. Explain the ways business can be financed in both one-man and in partnership.
2. Describe the method of sharing the cost of business.

7.0 REFERENCES/FURTHER READINGS

1. Heller, R (2002). Manager's Handbook, London: Dorling Kindersley Ltd.

2. Keith, L. and Grubellini, C. (1975). Introduction to Business Enterprises; New York: McGraw Hill.

3. Ross, S. A (1996). Essentials of corporate Finance, United States of America: Irwin/McGraw-Hill.

UNIT 2 INTRODUCTION TO FINANCE BY DEFINITION

CONTENTS

1.0 INTRODUCTION

Every business enterprise faces the problems of acquisitions of funds to carry out its operations. Further, it has to determine the optimum methods of employing the funds it has obtained. Financing, basically is the function in a business that is responsible for acquiring funds for the firm, managing funds within the firm and planning for the expenditure of funds on various assets. Such activities include preparing budget, cash flow analysis and planning for expenditure of funds on various items such as those relating to plants, equipment, machinery etc.

Albeit businesses generally have most of their funds tied up in the investment in the plants and inventories, continuous flow of such funds is needed into and out of the business. This flow of funds represents the blood stream of the business. Keeping close watch on the financing function is very important. In this unit, therefore, the various definitions of finance would be considered, objectives of financial management and the need for financial planning are also considered.

2.0 OBJECTIVES

At the end of this unit, you should be able to;

- Define finance
- Explain the functions of finance in business
- Discuss the objectives of financial management
- Explain the need for financial planning

3.0 MAIN CONTENT

3.1 MEANING OF FINANCE

The term finance has been defined as follows: “finance has aptly been called “the science of money”. It studies the principles and the methods of obtaining control of money from those who have saved it, and of administering it by those into whose control it passes”

(a) S. C. kuchhal, defines finance as, “finance may be defined as that administrative era or set of administrative functions in organization which relates with the arrangement of cash and credit so that the organization may have the means of carrying out its objectives as satisfactorily as possible”.

(b) Howard & Upton, look at finance as, “business finance includes those business activities which are concerned with the acquisition of and conservation of capital funds in meeting the financial needs and overall objectives of business enterprise”

(c) While Wheeler, defines finances as, "financial resources drive other resources in its train, for without finance other resources cannot be achieved. Finance is therefore, the basic resources used for creation of and maintenance of other resources.

SELF ASSESSMENT EXERCISE 1

1. Mention and discuss three (3) definitions of finance.

3.2 THE FUNCTION OF FINANCE IN BUSINESS

financial management is the managerial capability concerned with the planning and controlling of the firm's financial resources. Basically, there are two kinds of finance functions: managerial and incidental or routine functions.

3.2.1 MANAGERIAL FINANCE FUNCTION

This requires planning, controlling and execution abilities. The three important managerial finances functions are; investment decision (asset mix), financing decision (capital mix) and dividend decision (profit allocation) decision. (pandey, 1984; archer & dambrosio, 1976; graham & mcglorick 1984).

3.2.2 INCIDENTAL OR ROUTINE FINANCE FUNCTION

For effective execution of managerial finance functions, the incidental or routine functions must be performed. They include: Supervision of cash receipts, payments and the safeguarding of cash balance. Custody and safeguarding of securities, insurance policies and other valuable papers. Taking care of the mechanical details of new outside financing, record keeping and reporting.

The financial manager is mainly involved in the managerial finance functions, while the routine finance functions are carried out by the people of the lower levels (tijani-alewa, 2004).

SELF ASSESSMENT EXERCISE 2

1. Mention and discuss the two kinds of finance functions.

3.3 THE OBJECTIVE OF FINANCIAL MANAGEMENT.

If the future were perfectly known, business forecasts could be made without error. Financial management is that managerial activity that concerns planning and controlling the company's financial resources. According to economists, every resource is scarce and as a result, it requires planning and control in order to achieve the best out of the resources available and this is tied to finance (ndubuisi, 1998).

The objectives of financial management should be understood in the light of the objectives of the enterprise as a whole. The following objectives are hereby advanced:

1. Pay dividends
2. Maintain market price of the shares of stocks
3. Seeking growth of the company
4. Avoiding of high levels of risk
5. Maximization of profit and minimization of risk
6. The need to maintain some level of liquidity
7. Maintenance of control i.e. Proper safeguarding and utilization of funds.

SELF ASSESSMENT EXERCISE 3

1. Identify the various objectives of financial management.

3.4 THE NEED FOR FINANCIAL PLANNING.

Financial planning is deciding in advance the financial needs of a business to achieve the basic objective of the firm which is no more than getting the maximum profits out of minimum efforts. Therefore, the basic aim of financial plan is to get funds at the minimum cost and utilize them properly. In other words, financial planning involves the inflow and outflow of funds for the good of the business (varma and agarwal, 1988).

In an enterprise, there must be someone who pulls together, reviews, analyses, interprets and plans these requirements and consequences. The person who does this is the chief executive officer in charge of finance of the enterprise. According to jain (2000.), financial planning includes the following functions:

i) Determination of the financial resources required to meet the operating programme of the company.
ii) to work out as to how much of the requirements are to be met by generating funds internally by the company and how much is to be obtained from outside the company.
iii) To develop the best possible plans for obtaining the funds needed from the external sources.
iv) To establish and maintain a system of financial controls for governing the allocation and the use of funds.
v) Formulation of programme for the provision of the most effective relationships between product-cost-profit.
vi) Analysing the financial results of all operations
vii) Reporting these analysed facts to the top management of the enterprise.
viii) Making recommendations relating to future operations.

SELF ASSESSMENT EXERCISE 4

1. Itemize and briefly discuss the functions of financial planning.

4.0 CONCLUSION

The above discussions show that finance is quite relevant to any business concern. Hence, its function in business enterprises hinges specifically on acquiring funds for the firm, managing funds within the firm and planning for the expenditure of funds on various assets. In view of that, it is pertinent for business persons to get involved in the practice of acquisition, marshalling, planning and controlling funds. The reason is because finance is the basic resource used for the creation of and maintenance of other resources.

5.0 SUMMARY

In this unit, a lot issues were discussed. More light was shaded on the meaning and function of finance. We also discussed the objectives of financial management. Finally, we examined the need for financial planning in business enterprise.

6.0 TUTOR – MARKED ASSIGNMENT

1. Mention and discuss three (3) definitions of finance.
2. Identify and briefly discuss the two kinds of finance function you know.
3. Examine the functions of financial planning.

7.0 REFERENCES/FURTHER READINGS

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UNIT 3 THE RELATIONSHIP BETWEEN FINANCE AND OTHER DEPARTMENT OF AN ORGANIZATION

CONTENTS

1.0 INTRODUCTION

A healthy and vibrant economy needs a financial system that moves funds from people who have to those have not to have productive investment opportunities. How well your hard-earned savings get channeled to productive sector. The analysis also demonstrates the important link between the financial system and the performance of the aggregate economy. The relationship between finance department and other departments in an organization could be seen in the function performed by money or finance.

2.0 OBJECTIVES

This unit deals with the relationship between finance department and other departments in an organization in term of the following;

Medium of exchange

Unit of account

Store of value

3.0 MAINT CONTENT

3.1 MEDIUM OF EXCHANGE

In almost all transactions in an economy, money in the form of currency or cheque performs the function of medium of exchange. It is used to pay for goods and services. The uses of money as a medium of exchange promotes economic efficiency by minimizing the time spend in exchanging of goods and services. The finance department is the source of keeping other departments running in term of purchases and salaries of staff, and also encourages specialization amongst economic agents. Finance has eliminates the principle of double coincidence of wants as was experienced during the barter economy. People are encouraged to go about their duties rather than waste their time looking for people who have what they want and need what they have. Therefore, money or finance promotes economic efficiency by eliminating much of the time spent exchanging goods for services. It also promotes efficiency by allowing people to specialize in what they do best.

3.2 UNIT OF ACCOUNT

Finance also plays the role of a unit of account that is, it is used to measure value in the economy. People are ready to work and have their services valued in terms of the wages that will be paid for. It would have been much difficult in term of exchange of services Vis -a- vis the amount paid for the service.

The department of an organization will function well and reduces the problem of quoting prices in terms of units of that money rather than going around looking for who wants what they have and have what they need. Finance department restores confidence in other departments of an organization as money is being used as a unit of account reduces transaction costs in an organization.

3.3 STORE OF VALUE

Money also functions as a store of value; it is a repository of purchasing power over time. The store of value of money is used to save purchasing power from the time income is received until the time it is spent. The finance department of an organization serves as an engine room which gives life line to other departments in the organization as it solves their financial problems when one arises.

As people work, they are confident that as long as the finance department is functioning, their salaries are assured, no matter how long it will take to be paid. Any transaction in an organization ends in the finance department, either to pay or receive pay on behalf of the organization.

4.0 SUMMARY

Finance department is the life wire of any organization, whether profitable or non-profit organization. The department coordinates the activities of the organization, either to pay the salaries of workers or finances the activities of the organization. It is the department which other departments looked up to for any of its action or inaction.

5.0 CONCLUSION

The unit throws light on the importance of finance department in any organization. It also sees the activities of the finance department in terms of medium of exchange for services rendered, unit of account, and a store of value. Since people work and are not paid immediately and have to wait till the end of the month, and sometime more than a month before workers are paid.

6.0 TUTOR-MARKED ASSIGNMENT

1. Mention and explain how finance department is necessary in an organization

2. Identify and discuss the differences between the stored value and unit of account function of a finance department of an organization.

7.0 REFERENCES/FURTHER READINGS

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UNIT 4 FINANCE, ITS OPERATION AND THE OVERALL MANAGEMENT OF CORPORATION

CONTENTS

1.0 INTRODUCTION

Financial Management is the skill put forward by the managerial planning and control of financial resources of an organization to achieve the objectives of the business. Before now, it was considered to be as aspect of economics, but it is now looked at as a separate discipline. However, it still draws aspiration from economics for its theoretical framework.

Financial Management deals with the instrument, institutions and procedure in the capital market. It also has biasness in accounting records and reports, monitoring cash position and paying of bills in an organization. Thus, because of the importance of financial management in business, and its rigorousness in analysis, it is now more concerned with strategic financial decision making within an organization. The subject matter of financial management has grown to encompass rigorous analysis of investment of organization's funds in assets and obtaining the best mix of financing and dividend in relation to overall market valuation of a firm.

2.0 OBJECTIVES

This unit throws light on;

The corporate objectives

The roles of finance

Finance as a discipline in corporate governance

3.0 MAIN CONTENT

3.1 THE CORPORATE OBJECTIVES

The key thing in business success is the definition of the objective which sets in motion the target to be achieved. Business firms are profit seekers, thus, their goal objectives need can not be the same with organization which are run to provide social services to humanity, like Federal, State, and Local governments activities which are meant to satisfy their subjects.

3.1.1 MAXIMIZATION OF PROFIT

The ultimate aim of an investment is to maximize profit at a minimize cost. Therefore, businesses believe, as long as they are increasing in revenue while keeping cost at a minimum level, they are achieving their objective. In business, there are varying interests in the objectives of the organization, the shareholders, society, and mangers of the organization.

3.1.2 SHAREHOLDERS AND MANAGEMENT WEALTH MAXIMIZATION

One of the most important goals of business firm is maximization of the owners' interest is the firm maximization of value of the corporation share and social corporate responsibility can also be an important objective of the company. For instance helping to save energy or minimizing pollution in the host community. The goals and policies of an organization are determined theoretically by the owners of the business like the shareholders or stockholders who are represented by the board of directors. However, the executions of these policies or goals are in the hands of the management team. The Management is delegated by the board of directors to run the company. And the management of this company has its own interest, this conflict of interest sometime ruins or cause a fall or winding-up of the organization.

3.2.3 OWNERS' WEALTH MAXIMIZATION AND SOCIAL RESPONSIBILITY.

The goals of the owners of the business are wealth maximization which provide for efficient allocation of society's economic resources. Any deviation will lead to sub-optimal allocation of resources that have implication on the growth of an economy. When owners of businesses are pursuing wealth maximization objective, does not necessary implies fulfillment of their social responsibility as a firm. The social responsibility of a firm to its means is it profit. Since the firm needs to provide quality goods at low prices maintaining sound industrial relations, paying fair wages, maintaining fair recruitment practices, supporting education and sports activities and the host of others would erode its profit, firms are nonchalant about their provisions. There is, therefore, a conflict of interest between the shareholders wealth maximization and the society's welfare which might call for disagreement between the organization owners and the host communities as the case in the Niger Delta region of Nigeria.

SELF ASSESSMENT EXERCISE 1

1. Mention and discuss the company's corporate objectives.

3.2 THE ROLES OF FINANCE

The function of a financial manager must be evaluated in line with the overall objective of shareholders' wealth maximization. Finance functions involve three main types of managerial decisions; the investment decision, the financing decision, and the dividend decision. These decisions are interrelated and have impact on the market viability and price of a company's shares.

3.2.1 INVESTMENT DECISION

Every company aspires to grow and make profit now and in future. Therefore, the company's decision to allocate funds to investment proposals to yield future benefits is paramount. The future of the businesses are uncertain, investment proposal most necessary involve risk. However, investors have to be critical in evaluating the overall objective of shareholders' wealth maximization; consequently, they should be evaluated in relation to expected return and risk.

Apart from selecting new investments, a firm must also manage its existing assets. Financial managers should be concerned with current assets apart from fixed assets. The working capital of a company has more implication on the firm liquidity than its fixed asset; therefore, it needs to be managed efficiently in such a way as to maximize profitability relative to the amount of funds tied up.

3.2.2 FINANCING DECISION

This involves determining the best financing mix that could yield the company the nest profit. The financial manager should be able to source for fund for the company at the lowest cost such that there is a profit level of liquidity it maintains.

3.2.3 DIVIDEND DECISION

The decision on what should be given out as dividend out of the company's earnings and what to plough back into the business ought to be evaluated in the context of maximizing the wealth of shareholders; their opportunity cost of returned earnings must be balanced with any dividend to investors.

SELF ASSESSMENT EXERCISE 2

1 Discuss the roles finance plays in corporate decisions.

3.3 FINANCE AS A DISCIPLINE

The divide between ones income on consumption and investment is very vital, how to choose from among available investment opportunities and how to raise money to provide for increased consumption or investment.

Just as the individual seeks to maximize his or her happiness, the firm seeks to maximize the wealth of its owners' shareholding. In both the individual and company, the financial discipline will entail the prudency in the usage of the available resources at their disposal such that there is no surplus or deficit in any sector of ones life or the corporate existence of a firm.

4.0 SUMMARY

The prime motive of shareholders and management organization is generally maximization of the value of the owners' interest in the company (maximization of the value of the firm's shares); conflicts arise between shareholders, management, and society at large. The differences between shareholders and management can be minimized by various factors such as stock option plan, that make managers part owners or the possibility of the company's takeover by dissatisfied parties who would replace the existing management. In the case of social responsibility, the law encourages the prodding from the shareholders to provide for the host community with essential services.

5.0 CONCLUSION

In other to serve the interest of either the shareholders, managers, and/or the society, there is the need for prudency and cost effective in the sources of finance. This unit also showed how difficult it can be to simultaneously satisfy the shareholders' wealth maximization and the society's welfare. It shows therefore that the satisfaction of one is at the expense of the other.

6.0 TUTOR-MARKED ASSIGNMENT

1. Identify and discuss the various roles of finance in corporate governance.
2. Discuss the main corporate objectives of an organization.

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UNIT 5 TYPES, SOURCES AND APPLICATION OF FUNDS IN BUSINESS

CONTENTS

4.0 SUMMARY

5.0 CONCLUSION

6.0 TUTOR-MARKED ASSIGNMENT

7.0 REFERENCES/FURTHER READINGS

1.0 INTRODUCTION

Business is a venture that takes a serious and hard-working person to start. It is a venture that risk aversion person will never want to be associated with. According to Abraham (2003), "To achieve uncommon result in any business, vocation or career that you are in, you must be an adventurer, not a risk-averse person". In business, you need to take risk to succeed, therefore in taking the risk, you need to source for find either within or from sources outside your personal keeps.

The purpose of entering into business is to make a profit and remain in the business. Thus, in finding sources of finance, you need to take into account the cost of the fund vis-à-vis your profit. Any business that do not yield profit need not funded and might not attract financiers.

OBJECTIVES

You should be able to identify and explain the following at the end of this Unit. The unit content throws light on the itemized in detail.

The financial need of a business
Types and sources of funds
Sources of short, medium and long terms of funds

MAIN CONTENT

3.1 ESTIMATING THE FINANCIAL NEED OF A BUSINESS

In starting a business, the most important thing that needs to be given attention is the finance. Money is the basis for any start of business, the sources of getting this money are limited in term of small scale business unlike in the case of large scale businesses who raise their money from either equity or debt sources.
Another important issue you need to know here is the usage of the word Capital. In ordinary or business sense, Capital means the amount of money you provide for the purpose of starting a business. Nwoye (1994) sees capital as a fund employed in financing business operation, while Lyman, Keith, and Gubellini (1975) refer to capital as assets needed to operate a business. Capital might mean different thing to different people depending on the concept in which the word capital is used. To an Economist, capital to him means factor of production. Therefore, the word capital might not be loosely used but rather be conceptualized within the context it is used.

In new business you need to identify the following as the needs of the business before you could start the business, these are,

i The capital to cover the initial cost of the business

ii Capital to invest into fixed assets (like machinery, motor, equipment building etc)

iii Working capital (to cover expenses like salaries, repairs, daily running of the business etc)

iv Capital Reserves (money for exigencies or for the "raining day" as always term)

Estimate means the forecast of a business operation in future at present, by deciding the budget of the business which is the most important aspect of the management of a business. Budgeting means planning the activities of a business in quantitative statement, which is in figure. For the purpose of this unit, we shall classify budget into two types; operating and financial budgets. The operating budget consists of sales, materials, personnel, production and other operational activities of a business. This budget estimates the various activities hat will be carried out under every operation of the business. While on the other hand, the financial budget defines or forecasts the estimate of money receipts and payment made from the various operations. The financial budget reflects the effect of the firm's financial position and earnings potential as a result of its operation.

SELF ASSESSMENT EXERCISE 1

1. Identify and explain the needs for starting a new business.
2. Explain the need for estimation in a new business.

3.2 TYPES AND SOURCES OF FUNDS FOR BUSINESS

Investment decisions need to consider and identify the various investment opportunities, comparison and evaluation of these opportunities such that the selection of these opportunities will be based on the availability, characteristic, and cost of sources of funds for the business which are based on the following Short-term, Medium-term and Long-term sources.

3.2.1 SHORT-TERM SOURCES OF FUNDS

Working capital as earlier mentioned is that money which is used for the running of the day-to-day activities of a business. Therefore, the short-term sources of funds are those funds needed to finance the shortages in the working capital of a business. This fund should not, if it can be avoided, be used for long term investments. The main sources of short-term funds are;

(a) Loan from friends and relatives

(b) Bank credit (bank overdraft)

(c) Commercial or Trade credit

(d) Inheritance

(e) Factoring

(A) LOANS FROM FRIENDS AND RELATIVES

Good and reliable friends and relatives could be ready to assist their friend or relative to start a business by contributing to funds for the business, such funds therefore, is invested and the business become successful. However, these sources of funds might spell doom for the business, particularly if the business is successful. At times, at no notice these friends or relations, out of jealousy demand the refund of their money which might cause the closure of such business.

(B) BANK CREDIT (BANK OVRDREAFT)

This is another way of obtaining short-term funds, this time, is from the bank. Overdraft arrangement is quite different from bank loans. A business can enjoy overdraft depending on her relationship with the bank and how the business account has been operating over time. The overdraft is a privilege which the bank grants its customers to overdrawn its account over and above the balance it has to be paid normally within one to three months with an interest to be charged on a daily basis.

(C) COMMERCIAL OR TRADE CREDIT

A business that has good reputation, human relations and connections could have goods and services rendered to it by bigger companies by supplying it with goods on credit or with part payments. In such cases, it is more like more money has been put into the business by the bigger company. In advanced countries, there are more trade credit varieties like trade acceptances and promissory note. Trade acceptance is a draft drawn by the seller against the buyer for an amount of credit extended to him to be paid at a specified date which the buyer must accept by signing the draft. But a promissory note is an unconditional promise to pay a specified sum of money to a specified person at a definite future date.

(D) INHERITANCE OR BEQUITMENT

These are entitlement of materials (money inclusive) which a person receives as part of the properties of his parents or relatives who may (or may not) have died to serve as a source of fund for the start of his business. It is not incumbent on the benefactor to invest the said entitlement in business, but it is another ways in which people could raise fund for starting a business.

(E) FACTORING

This is a situation where debtors of a company accounts could be bought over by say a bank or it subsidiary at a percentage such that the company enjoys the leverage of say 5 per cent. The company will now enjoy her money owned her less the percentage before the maturity of the debt. For instance, your debtors owed you – say 100 million, you can factored this debt to a bank or its agent by collecting the value of the debt from the bank less the 5%. This means that the bank will pay you 95 million and take over the debtors and pursue to recover the debt from your debtors. These and so many other forms of financing business or raising funds to finance businesses are therein.

SELF ASSESSMENT EXERCISE 2

1. Discuss the different ways the short-term sources of funds can be raised.

3.2.2 MEDIUM-TERM OF SOURCING FUNDS FOR BUSINESS

This period is not that short nor long enough for source of fund to mature for repayment. However, the period bridges the gap between short and long period to finance businesses that would not fit into short nor long gestation period. The sources of funds that fall under this period are as follows;

(a) Bank Term loan
(b) Venture capital
(c) Project finance
(d) Equipment leasing

(A) BANK TERM LOANS

This is a bank loan which might be like overdraft but this has a long gestation period (that is long maturity period for repayment cum the interest). The interest charge on the bank term is higher than the overdraft and its security – collateral is also higher. The bank scrutiny of the business under this loan is more stringent that in the ordinary loan.

(B) VENTURE CAPITAL

These are monies used in venturing into a business with a high uncertainty of products at initial formulation and marketing of the products. This money could be called seed money because it is needed to develop a concept of the product or service. Just like planting seeds into the soil to produce the require grains once it germinates. At times these seeds might not or might, depending on the soil and how the Almighty wants it. Venturing money may not produce proceeds for the business that is not to say you will not venture because of the probability. This is why it is regarded as highly uncertain.

(C) PROJECT FINANCE

Under this source of funds, the project is expected to sustain itself without considering the financial standing of the borrower of the fund. Once the fund is borrowed to start the business, it is the business that pays back the fund from the proceeds of the business with interest of the loan and also profit to the owner of the business too.

(D) EQUIPMENT LEASING

This method of financing business where equipment for the business is loaned out to the user (Leasee) by the owner (Leasor) under an agreement which requires the Leasee to pay the agreed value of the equipment to the Leasor the sum of money for a determined period of time. Thus, leasing agreement is done in such a way that the business (Leasee) chooses the equipment it wants to use for the business and these equipment are bought by the Leasor. An agreement is therein drawn up between the Leasor and the Leasee indicating the terms of the contract and the amount of the rental to be paid at a given period. This agreement allows the Leasor the legal title of the assets while the Leasee has a complete possession and use of the asset without having to pay for its purchase. The legal title of the equipment can only be transferred to the Leasee after a complete payment of the cost of the equipment at the end of the contract terms.

3.2.3 LONG-TERM SOURCES OF FUNDS

The long-term of sourcing funds could be for a period as long as five years or more. The long-term financing in must cases are used to finance fixed and current assets of the business. The main sources of long term funds are;

(a) Equity capital

(b) Ordinary share capital

(c) Debenture stock capital

(A) EQUITY SHARE CAPITAL

The holders of these shares in a company are the owners of the business. Shareholders have rights to anything of value that the company may wish to share and as well as the ultimate control of the company's affairs. The liabilities of the company at the point of winding up or bankruptcy rest heavily on the equity shareholders.

(B) ORDINARY SHAREHOLDERS

The ordinary shareholders have voting rights equals their investment in the company and cannot reclaim or redeem their shares except by rights of selling. Ordinary shares could be in form of preferred or deferred ordinary shares. The preferred ordinary share has a fixed rate of dividend and can also be entitled to a further share of profit after their fixed dividend. While deferred ordinary share is that who takes his share of the profit of the company last after all other claims must have be paid.

(C) **DEBENTURE STOCK CAPITAL**

These are long-term loans which could be secured or unsecured that a business might obtain to finance long term matured business. This debenture represents the document which acknowledges the indebtedness to the company. Debenture could be redeemable or irredeemable. A redeemable debenture is that which on the other hand, an irredeemable debenture is one which is repayable only in a situation of contingency, that is, when the business is winding-up or going bankrupt.

4.0 SUMMARY

This Unit has highlighted the importance of financial need of a venture in relation to the nature of the business. It also identified the types of funds to be raised and how to raise such funds for sustainability of the business.

5.0 CONCLUSION

The analyses in this Unit give different ways of financing a business, the need to identify then sources of funds for the business such that you do not use then wrong sources of fund to finance your business. A wrong source of fund could cause the collapse or bankruptcy of the business. You should be able to use short-term fund to finance short-term yielding business while long-term fund could be used for both short term and long-term yielding ventures. The analyses also shown how and where to go for funds to finance a business venture.

6.0 TUTOR-MARKED ASSIGNMENT

1. Identify the various ways in which funds can be sourced and explain them.
2. Discuss the differences between the short-term and long-term sources of funds.

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MODULE 2

Unit 1 –WAYS OF SOURCING/RAISING FUNDS FOR RUNNING A BUSINESS

CONTENTS

1.0 INTRODUCTION

Every step in an organization and development of a business enterprise, every manufacturing/service operations and every marketing activity, requires the use of funds in one way or the other. The cost of land, buildings, tools, equipment, materials, supplies, wages, fringe benefits, taxes, electricity bills are paid for with funds. Many business persons underestimate the amount of funds required to put business on a profitable basis. Hence, have little or no knowledge of the best way(s) to source for funds. This failure to appreciate and/ or ascertain the financial requirement as well as the best possible means of sourcing for funds has been the chief causes of business failures.

Some concerns source for enough funds to be self-supporting from the very start. Others, however, may need several months or even years before they generate sufficient funds to catch up with the outlays/ operations required. These contingencies should be anticipated by business persons when sourcing/ raising funds for their businesses otherwise, the business that might highly be successful may fail without such precut. In this unit, hence, we shall be dwelling particularly on the various ways of sourcing/ raising funds for running a business.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

i) Identify the needs for funds in a business enterprise

ii) Discuss the traditional sources of funds

iii) Explain the institutional sources of funds

3.0 MAIN CONTENT

3.1 NEED FOR FUNDS IN A BUSINESS ENTERPRISE

On identifying a certified proposal for investment worth, the next line of action is determining the various ways of sourcing for funds for the business. The entrepreneur must see to the proper funding of the business because too much funds is not healthy for a business and inadequate funds is also detrimental to the running of a business. This also anchors on the fact that, excess funds raised will lead to overcapitalization whereby the earnings of the firm will be spread to large amount of capital assets. In this regard, it is not unlikely that some of the assets will be idle or under-utilized. Whereas, inadequate funds raised, will lead to under capitalization and suffocation of working capital operations.

The need for funds requirement of the investors, shareholders, employees, managers, innovation, and expansion revolves around the present finances raised. An efficient and effective raising of funds will lead to sound and profitable business. Hence, the knowledge of the sources of funds, its costs and implications become paramount to business individuals in this millennium.

SELF ASSESSMENT EXERCISE 1

1. Discuss the needs for funds in any business enterprise of your choice.

3.1 CLASSIFICATION OF FUND SOURCING

Funding sources are the sources from which an entrepreneur obtains the funds necessary to start up or operate a business. There are several sources available for such funds, also called capital. They are classified under two categories-traditional and institutional sources-as discussed below:

A) TRADITIONAL SOURCES: the main sources for raising funds by an enterprise are as follows:

3.1.1 SELF-FINANCING

The only original source of financing is the personal savings (ndubuisi, 2000). The owner can finance it himself or herself through savings or other available personal resources. He may invest through the purchase of shares or debentures with past savings he has made.

3.1.2 PEOPLE-TO-PEOPLE LENDING

While borrowing from friends and family for business has been long-practiced, new services and markets to respond to the needs of "social finance" or "people-to-people" lending are emerging. In some cases, these online services provide a marketplace between lenders and borrowers. Prosper is a U.S.-based company that allows you to request a loan and other people can bid on your loan. Zopa is another UK based version. While the U.S. start up loan back is not a "marketplace" for loan-brokering, it provides individuals and small businesses the opportunity to set up and schedule promissory notes and payment schedules.

3.1.3 GRANTS

In certain circumstances and for small businesses in specific enterprises and niches, sources of funding may be available from governmental or private sources in the form of **grants**. Unlike a loan, these funds are typically not paid back to the source. However, grants come with requirements attached. These requirements can range from research results, reports or specific products and services. Grants can be available from a wide array of sources including federal government agencies, state government agencies, or grants from educational or corporate institutions and private foundations.

3.1.4 PLOUGHING BACK OF PROFITS

According to Jain (1999), the process of creating corporate savings and their utilization in the business is technically called “ploughing back of profits”. It is an ideal method of financing special working capital needs of an enterprise.

B) INSTITUTIONAL SOURCES- the following are the main institutional sources for raising capital by an enterprise:

3.2.1 STOCK EXCHANGE

An entrepreneur can finance a business by getting investors to purchase stocks in the company (although there would be legal problems if it were offered to the general public). A partnership can be formed or perhaps a venture capitalist could provide funds if the business venture plans were sound enough. There are some early stage investors called “angel investors” who invest in startup enterprises. Friends and relatives can also loan money. Here, an entrepreneur should realize that if anyone else participates in the venture some elements of control will be lost. All investors should be aware of the risks involved when one invests in a startup business.

3.2.2 BANK LOANS

An entrepreneur can also raise capital for a business using an equity loan on his home or other assets he or she may own. Many entrepreneurs seek a bank loan in the name of their business, however banks will usually insist on a personal guarantee by the business owner. In the United States, the Small Business Administration (SBA) runs several loan programmes that may help small businesses secure loans. In these programmes, the SBA guarantees a portion of the loan to the issuing bank and thus relieves the bank of some of the risk of extending the loan to a small business.

3.2.3 INSURANCE COMPANIES

Insurance companies have also made a great contribution in providing capital to business enterprises. These companies invest their capital in the shares and debentures of the business enterprises.

SELF ASSESSMENT EXERCISE 2

1. Identify and explain two of each of the traditional and institutional ways of sourcing/raising funds

4.0 CONCLUSION

In our discussion, we realized that finance is a key to any business enterprise. Hence, the ways of sourcing it has been of great challenge to entrepreneurs. Some entrepreneurs source for enough funds to be self-supporting from the very start. Others, however, may need several months or even years before they generate sufficient funds to catch up with the outlays/ operations required. These contingencies should be anticipated by business persons when sourcing/ raising funds for their businesses otherwise, the business that might highly be successful may fail without such precautions.

5.0 SUMMARY

The unit has thrown light on the need for funds in a business enterprise. The two classification of sourcing/raising funds, i.e. the traditional sources (self-financing, people-to-people, grants, ploughing back of profits) and institutional sources (stock exchange, bank loans, insurance companies), were also highlighted and discussed.

In the next unit, you will be taken through the discussion on the types of capital-fixed and circulated/working.

6.0 TUTOR-MARKED ASSIGNMENT

1. Identify and explain two of each of the traditional and institutional ways of sourcing/raising funds

2. Discuss the needs for funds in any business enterprise.

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UNIT 2 THE DEFINITION OF CAPITAL AND ITS FORMATION

CONTENTS

3.1 Meaning of capital formation

3.2 Importance of capital formation

3.3 Reasons of low rate of capital formation

3.4 Sources of capital formation.

4.0 SUMMARY

5.0 CONCLUSION

6.0 TUTOR-MARKED ASSIGNMENT

7.0 REFERENCES/FURTHER READINGS

1.0 INTRODUCTION

Every society needs one form of capital or the other, if not all, to develop in its economy. No economy can forge ahead without making adequate arrangement in its capital formation. According to Levacic (1982), capital is the accumulation of wealth which must be combined with other factors of production. In the same light, Jhingan (1997) sees capital as the combination of material and human that result in the products for final consumption. If these definitions of capital are things to go by, then capital must be vital in the life of every economy.

2.0 OBJECTIVES

This Unit throws light and explains in detail the following items. You are expected to, at the end of the unit, should be able to understand the conceptual, importance, and sources of capital formation.

The concept and definition of capital
The importance of capital formation
Why there is a low rate of capital formation
The sources of capital formation

3.0 MAIN CONTENT

3.1 THE MEANING/CONCEPT OF CAPITAL FORMATION

In both developed and developing economies, emphasis is laid on the formation of capital as the critical determinant of economic growth. There is no society that directs her whole resources into the productive sector, but however, part of it is directed to the formation of capital goods which will be further channeled into further production. These capital goods include tools, machines, plant and equipment. This means that business has to postpone or deferred her present consumption in favour of the accumulation of capital to further increase or expand her consumable goods in future, such that her income increases.

This argument as supported by Kuznet that the domestic capital formation should be such that it will not only add to the constructions, equipment and inventories of a country but also other expenditure, except those necessary to sustain output at existing levels. He sees the deferment of present consumption in form of capital formation will display outlays on education, recreation and material luxuries which will contribute to the health and productivity of individuals and raise their morale. Therefore, businesses need to defer the consumption of the present profit and plough it back to the business so that it could expand and increase it output which implies better profits.

3.2 IMPORTANCE OF CAPITAL FORMATION

Capital formation (or accumulation of wealth) is one of the must important and principal factors in economic development. Most economists believe that the vicious circle of poverty can be broken with the formation of capital. This the believe that the formation of capital leads to full utilization of available resources, increase in output, income and employment which will solve the problem of inflation balance of payments deficit and relief a country of burden of foreign debts and a better domestic commerce. These indices are blocks to any reasonable business that can be embarked upon domestically.

Therefore, the formation of capital builds up capital equipment in almost all, if not all, sectors of the economic which raises the domestic savings and investment capacities of both the buyers and sellers of goods.

Capital formation will dispenses (distributes) to businesses, depending on loans from banks or friends, cash to expand in businesses.

Capital formation will put more money on the hands of investors in businesses which will lead to establishment of different types of industries, increase levels of income and people will have their wants satisfied. This will also raise the standard of living of the people and the economic welfare of business owners will also increase.

Capital formation does not only solve the problem of business owners, but it is the principal solution to the complex problems of underdeveloped countries in general.

3.3 REASONS FOR LOW RATE OF CAPITAL

The characteristics that identify low rate of capital formation in Less Developed Countries (LDCs) like ours depend largely upon our culture to savings, the institutions mobilizing these savings, and the investment of these savings. These could be properly put as below;

(a) The low income nature of the LDCs account largely for low capital formation. A large savings are essential for capital formation which also depends on the size of income of the economic agents. In general terms, the economies of the LDCs are backward in all her sectors. As a result our per capita income is also low. Low income leads to a higher propensity to consume leaving nothing to save as a way of capital formation.

(b) The size of dependants on prospective investors with the low per capita income provides little or no income to save as a way of capital formation. Moreover, the LDCs economics have large per cent of children in their population creating a heavy burden on the parents in bringing them up. This eats up the hunk of their income leaving nothing to save. The life expectancy in the LDCs is very low or short; workers die in their prime ages, there by leaving few adults within the working age brackets to carter for the children and invest in business.

(c) There are high inequalities in income distribution which creates gap between savings and consumption. Though income inequalities do not imply larger savings, but the disparity in income brings distortion in real investment and the rate of capital formation. People have to look on to others to assist or provide them with loan to invest in business.

(d) Capital formation is been retarded by the backwardness in technology. As a result, per unit labour productivity and per unit capital productivity remain low.

3.4 SOURCES OF CAPITAL FORMATION

The sources of capital formation could be seen in the increase in income of the people. This can be done by the capacity utilization of the resources of the society of a country in an efficient manner by utilizing unused resources productively through increase in division of labour.

Perpetuation of income inequalities in most of countries, particularly developing countries like ours, the mass of the people have low income and their marginal propensity to save is very low. It is believed that only those with high income that will have high marginal propensity to save and invest for capital formation.

Another way of capital formation is the increase in the profit of business investment. There is the tendency for the capital of an individual or business to increase rapidly if investment opportunities are very profitable. As a way out, the government can assist to build-up profit by giving subsidies and tax rebates to companies.

4.0 SUMMARY

The Unit threw light on how capital formation can be achieved through the various approaches. These approaches suggest that capital formation is very important for any economic growth and development. We also saw how capital formation both in human and materials as the best combination for rapid development in an economy.

5.0 CONCLUSION

The analyses show that capital formation is very vital in the business circle; it serves as the basis in which investment can be increased. Therefore, it is very essential for business owners to save as a way of capital formation, which will eventually increase their investment portfolio.

6.0 TUTOR-MARKED ASSIGNMENT

1. Identify the importance of capital formation to an economy?
2. Mention and discuss four of the reasons for low rate of capital formation.
3. Identify and discuss the sources of capital formation.

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UNIT 3 TYPES OF CAPITAL: FIXED AND CIRCULATED /WORKINGCAPITAL

CONTENTS

7.0 REFERENCES/FURTHER READINGS

1.0 INTRODUCTION

The appetite of organizations for capital is insatiable. Understanding the nature of capital and its effective allocation is essential to organization success. If challenged about the prime motive of profit maximization, most business people look dumb founded, saying, "it has always been that way". But business as we know today is only 200 years old. Today's capitalism was conceived by a small handful of 18th c enlightenment philosophers inspired by Newtonian mechanism. Their idea of capital was solely material capital – measured in money. However, the challenge is to decide which division, project, or acquisition gets scarce capital (Gary, 2000). This challenge varies with the type of capital.

Capital according to Francis (1995), is that which confers wealth, profit, advantage, or power. This implies that no business can continue for long without knowing what the capital it has (fixed or working) at its disposal, and using them efficiently. Sound capital, is a reflection of organizational strength, and is invariably evaluated by potential investors, creditors and other stake holders. In this unit, therefore, we shall lay emphasis on the types of capital – fixed and circulated or working.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Explain the terms fixed and working capital
- Discuss the management of fixed capital
- Explain the classification of working capital
- Discuss factors affecting working capital requirements
- Distinguish between fixed capital and working capital.

3.0 MAIN CONTENT

3.1 MANAGEMENT OF FIXED CAPITAL

It is said that fixed assets constitute fixed capital. They are land, plant, machinery, often called permanent assets. Fixed assets are not convertible into cash within one year. They fall within the area of fixed capital and capital budgeting.

Fixed capital management is concerned with the problem that arises in an attempt to manage the fixed assets.

OBJECTIVES OF FIXED CAPITAL MANAGEMENT

i) The goal of fixed capital management is to manage the firms fixed assets in such a way that a satisfactory level of fixed capital is maintained. The fixed capital should be enough to ensure margin of safety for the firm.

ii) Each of the fixed assets must be managed efficiently in order to avoid over capitalization/under capitalization.

iii) Each of the long-term sources of finance must be continuously managed to ensure that they are obtained and used in the best possible manner, since a lot of cost is involved in their acquisition.

SELF ASSESSMENT EXERCISE 1

1. Identify the objectives of fixed capital management.

3.2 MEANING AND CLASSIFICATION OF WORKING CAPITAL

Working capital represents that part of the capital which is invested in current assets like stock of raw materials and finished goods, bills receivable, accounts receivable and for meeting current expenses like wages, salaries, rent etc (Jain 1999).

There are two concepts of working capital: “gross” and “net”. The term “gross wc”, also referred to as working capital, means the total current assets”. The term “net working capital” can be defined as:

i) The difference between current assets and current liabilities,

ii) Alternatively, that position of a firm’s current assets which is financed with long-term funds.

Sufficiency of working capital is needed for the management of a business. No business concern can be successful if it has got no sufficient supply of working/circulated capital. Funds needed for operating needs to differ from time to time in every business but some amount is needed to carry out business efficiently. In view of that, working capital could be classified into two as thus:

3.2.1 PERMANENT OR FIXED WORKING CAPITAL

As the word depicts, is that part of capital which is permanently locked up in the circulation of current assets and in keeping it moving. Every manufacturing concern has to maintain stock of raw materials, work-in-progress, finished products, loose tools and equipment. If requires money for the payment of wages and salaries throughout the year.

It can again be sub-divided into:

a. Regular working capital and

b. Reserve margin or cushion working capital.

3.2.2VARIABLE WORKING CAPITAL

The variable working capital changes with the volume of business. It may be sub-divided into (a) seasonal and (b) special working capital. In some businesses, like sugarcane, operations are seasonal, so working capital requirements change greatly during the year. The capital required to meet the seasonal needs of industry is termed seasonal working capital. While special working capital is that variable capital which is needed to finance special operations like the inauguration of extensive marketing campaigns, experiments with products or with methods of distribution, carrying out special jobs and similar other operations that are outside the usual business of buying, fabricating and setting.

SELF ASSESSMENT EXERCISE 2

1. Mention and discuss the classification of working capital

3.3 FACTORS AFFECTING WORKING CAPITAL REQUIREMENTS

As earlier on mentioned, sufficient of working capital is needed for the management of a business. Too much capital is not beneficial to an enterprise. As much as possible, an enterprise should strive towards achieving a commensurate working capital. There are no set rules or formula to determine the working capital required by an organization. However, the following factors influence the working capital requirements of a firm (jain and khan, 1990):

3.3.1 NATURE OF BUSINESS

The nature of business determines the requirements of the working capital. Some companies require little working capital while others are working capital intensive for example retail businesses and construction firms need to invest substantially in working capital and less amount in fixed assets. In contrast, parastatal such as PHCN has very little need for working capital and needs to invest abundantly in fixed assets.

3.3.2 SALES AND DEMAND CONDITIONS

The availability of funds, type of products and sales environment will determine the extent of working capital requirement. The classes of customers, the price and quality of products, determine the level of sales and therefore, the amount of investment in finished products and debtors. Some products also have high degree of seasonal variability, e.g, household products are sold purely on cash basis depending on the demand for the product

3.3.3 MANUFACTURING PROCESS

The time lag of production from the input of raw materials to finished goods also affects the requirement for working capital. For example, the manufacturing of products such as soap and detergents may be produced within a day and the sales proceeds could be realized immediately while manufacturing of products like cars can take months and sales can be gradual and most times they might be on credits.

3.3.4 CREDIT POLICY

Credit terms granted by a company to its customers may depend on the norms of the industry in which the company operates. For instance, pharmaceutical companies deal mainly in cash while hoteliers may give, say two weeks or more for corporate guest to settle their bills.

3.3.5 CREDIT GRANTED BY SUPPLIERS

A company will need less working capital if liberal credit terms are available to it. For example, a company that enjoys less credit period than it gives its customers would have high need for short term funds than a firm which enjoys greater credit period from its suppliers than it gives its customers. The availability of credits from banks also influences the working capital requirements. A firm which can get bank credit easily on favorable conditions will operate with less working capital than firms without such facility.

3.3.6 PRICE LEVEL CHANGES

Price is relevant to purchases of material, manufacturing of finished and eventual sales. The increasing shift in price level makes the function of the financial manager more difficult. Generally rising price levels will require a firm to maintain higher amount of working capital. Same level of current assets will need to be increased when prices are rising, most especially stock level, however, debtors needs to be reduced during this period because the fall in the value of money. But when prices are generally falling, companies are advised to invest less in stock and more in debtors.

The enumerated factors are cardinal in deciding the amount of working capital, the proportion of working capital to fixed capital and the period of operations. An astute business person that understands these factors will be able to sufficiently manage working capital towards the achievement of the overall business objective.

SELF ASSESMENT EXERCISE 3

1. Enumerate and explain the various factors affecting working capital requirements of any business enterprise of your choice.

3.4 DISTINCTION BETWEEN FIXED CAPITAL AND WORKING CAPITAL.

The capital invested to fixed assets is always referred to as fixed capital. The capital invested in the current assets is termed current capital. The primary distinction between fixed and current capital are constantly changing in form. According to Jain (1999), there are two points of difference between fixed capital (fixed assets) and current capital (current assets):

i) The first difference is durability of their economic life. As stated earlier, fixed assets (fixed capital) have their lives for more than one year. Moreover, they are not convertible into cash within one year.

ii) The second difference is regarding divisibility. Investment in current assets is more divisible than investment in fixed assets. By and large, investment in fixed assets enhances the future earning capacity and improves the growth prospects of the business investments, it is important to ascertain the feasibility of the project and to evaluate its benefits.

SELF ASSESSMENT EXERCISE 4

1. Discuss the differences between fixed capital and working capital.

4.0 CONCLUSION

Our discussions reveal that the two types of capital (fixed and circulated or working) are quite vital to any business concern. Hence, entrepreneurs or managers of enterprises ought to be involved in the management of those types of capital, should also ascertain the various factors affecting particularly, working capital, the classification of working capital and their relevance to their enterprises. The major reason for that is for them to decide on which division, project or acquisition gets a particular type of capital. This will go a long way in propelling the wheels of the enterprise.

5.0 SUMMARY

The unit has shaded more light on the types of capital. Management of fixed capital was discussed meaning and classification of working capital along with factors affecting working capital requirements were also discussed. Finally, we examined the distinction between fixed capital and working capital. In the next study unit, we will take you through the measurement of capital.

6.0 TUTOR – MARKED ASSIGNMENT

1. Identify and explain the objectives of fixed capital management.
2. Mention and discuss the various conditions affecting working capital requirements in the Nigerian manufacturing industries.

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UNIT 4: MEASUREMENT OF CAPITAL

CONTENTS:

1.0 INTRODUCTION

The theory of capital is one of the most difficult and contentious area of economic theory. From Karl Max to the Cambridge controversies there has been an on going disagreement amongst economists as to what capital is, and how it should be measured. Economists have variously define capital as congeal labor, as deferred consumption as the “ degree of round- a-bout ness” as stock of durable commodities or as a flow of factor services. There is also disagreement about whether capital can be aggregated into a single measure and even within the relatively hospitable confines of neoclassical theory, exact aggregate is known to be problematic.

This presents the practical economists with something of a dilemma since many interesting economic problems require a measure of capital. How for instance, are we to understand the process of economic growth if we can not agree on how to measure one of the potentially most important factors influencing the process? What can we say about such an important issue? As the productivity slows down and why growth rates differ across the Nigerian economy? These issues are too important to be ignored an estimate of capital, income, and wealth however; imperfect must somehow be developed in order to get on with the larger tax at hand.

In this unit, therefore, applied capital theory, the need for capital measurement and ways of measuring capital are considered.

2.0 OBJECTIVES

At the end of this unit you should be able to:

- Explain the applied theory of capital
- Discuss the need for capital measurement
- Explain the method of measuring capital

3.0 MAIN CONTENT

3.1 APPLIED CAPITAL THEORY

Two aspects of capital (including human capital) differentiates it from a primary input like labour-capital is a produce means of production, and capital is durable. The first aspect is the primary source of the Cambridge controversy in pure theory, but the latter causes much of the difficulty in measuring capital. Durability means that a capital growth is productive for two or more time periods and this in turn implies that the distinction must be made between the value of using or renting in any year and the value of all the capital assets.

This distinction will not necessarily lead to a measurement problem if capital services used in any given period were paid for in that period, that is if all capital were rented. In this case, transactions in the rental market will fix the quantity of capital in each time period much as data on the price and quantity of labour services are derived from labour market transactions. But unfortunately, much capital is utilized by its owner and transfer of capital service between owner and user results in an implicit rent typically not observe by the statistician. Market data thus inadequate for the task of directly estimating the price and quantity of capital services, and this has led to the development of indirect procedures for inferring the quantity of capital like the perpetual inventory method or the acceptance of flawed method for example book value.

SELF ASSESSMENT EXERCISE 1

1. Identify and discuss the applied theory of capital

3.2 THE NEED FOR CAPITAL MEASUREMENT

A company that is not making optimum use of its resources is either over capitalized or under-trading. Over capitalization arises when a company tries to conduct a volume of trade over and above that for which it is financially equipped. On the other hand, under capitalization occurs when a company manages its capital inefficiently, so that there are excessive stock, debtors and cash and very few creditors, there will be an over investment by company in capital assets.

In view of the above, it becomes necessary to measure the capital required by an organization due to the following reasons

- To avoid too much investment in fixed assets above the company's requirement.
- To check incidence of high investment in current assets such as stocks and debtors
- To avoid fall in profit margin as a result of too much discount given to debtors in order to reduce average collection period.
- To avoid under utilization of capital employed.
- To improve the Return On Capital Employed (ROCE) that is the profit attributable to the providers of capital.

SELF ASSESSMENT EXERCISE 2

1. Discuss why you think is necessary for businesses to measure their capital requirement?

3.3 WAYS OF MEASURING CAPITAL

There are various ways in which capital can be measured depending on the reason for the measurement. For the purpose of this study, we shall concentrate the use of accounting ratios.

There are ratios which can assist in judging whether investment in capital is reasonable to avoid under or over capitalization.

The following ratios are useful in measuring working capital requirement of a company.

3.3.1 SALES/WORKING CAPITAL

The volume of sales as in multiple of working capital investment should be able to indicate whether, in comparison with previous years or similar companies, the normal volume of working capital is too high.

3.3.2 CURRENT ASSETS /CURRENT LIABILITIES

The standard ratio for this is 2:1, if the ratio is in excess of this it means there is over investment in current assets.

3.3.3 CURRENT ASSETS LESS STOCK/ CURRENT LIABILITIES

This is called quick ratio or acid test. This ratio measures how the liquid current assets can finance the current liabilities without hitch.

The standard ratio is 1:1

3.3.4 AVERAGE DEBTORS / TOTAL SALES

This ratio measures the number of days it takes for debtors to settle their account. This important in order to avoid over investment in debtors.

3.3.5 STOCK/ COST OF SALES

This is otherwise known as stock turn over ratio, it measures how much of stock is sold within one year.

3.4 EFFICIENCY RATIOS

3.4.1 NET PROFIT AFTER TAX/NET CAPITAL EMPLOYED

This is a primary ratio as it measures the primary aim of business, which is return on the funds invested. It is known as 'roce.' If this ratio is low, it means the company is using too much capital than it requires for the level.

3.4.2 SALES/ TOTAL ASSETS

of profit it is making.This ratio measures how the total assets are used in generating the sales. Low ratio means under utilization of assets.

3.4.3 SHAREHOLDERS' FUNDS/ TOTAL FIXED ASSETS

This ratio is known as proprietary ratio: it measures the adequacy of security to pay all liabilities. It serves as a test of long term financial stability of the company.

SELF ASSESSMENT EXERCISE 3

1. Discuss how you will know if a company is employing too much capital above the minimum it requires for the current level of sales?

4.0 CONCLUSIONS

From the above, it can be seen that measurement of capital is very essential in business. A company may be making profit and yet suffers from lack sufficient funds for the day to day running of a company. Over or under capitalization should be avoided because either is too dangerous. Managers at all levels need to know the amount of capital that is required to finance the level of operation of the company they manage.

5.0 SUMMARY

This unit has highlighted the theory of applied capital theory, the need for organizations to measure their capital, and the use of ratios in measuring the capital requirement.

6.0 TUTOR MARKED ASSIGNMENT

1. Explain why businesses need to measure their capital requirement.
2. Discuss how capital can be measured.

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UNIT 5 THE ACQUISITION AND USE OF RESOURCES

CONTENTS

1.0 INTRODUCTION.

Resources in business is like the blood that runs through the human system, such that without blood, the humand system fails. In the same light resoureces are the blood that runs through businesses system, and once the resources cut, businesses cease to flow. According to Stoner and Hattwick (1998), “ Resources are the fuel for businesses just as gasoline is the fuel for automobiles. Once businesses have the wrong resources mix, it will operate abnormally just like a car that runs on a bad fuel is having insufficient fuel to run properly.

This, therefore, caalls for business managers to be able to balance the need fro each of the resources, acquire them, and allocate them properly amongst the units of the business. This responsibility throws a challenge to business managers to see the importance of this aspect of business as a lead way to buildidng a seccessful business. Resources provide the basic ingredients that make a successful business. Resources in business are the people, physical, material, financial assets, and the information which the managers of firm need for a better products or services. Once the manager of a business fail to have the right mix or the absence of the resoureces means creating clog in the wheel of success for the business. This is why manager have to spend the better part of their time providing an appropriate mix of resource, nurture them and using them for the success of their firms.

OBJECTIVES

At the end of this unit you would have be able to:

Explain the nature of resources, its acquisition and use

Discuss in entail the opportunity cost and trad-offs of resource.

Explain fully the flow of resources.

Shows how the right mix of resources can be attained.

Know the right mix and allocation of resources.

MAIN CONTENT

THE NATURE OF RESOURCE ACQUISITION AND USE.

Managers of businesses whether one-man or limited liabilities resources acquisition and use is one of the must challenging areas. As manager of a business, you need to work with you subordinates as a team to have a balanced mix. Once you act in isolation, you will create deficit in onje unit and surplus in another. Therefore, there is the need for consultation so that when new plant and equipment are to be acquired will not only involve the financial resoureces, but also may require extra training of employees in order to use the equipment efficiently and effectively.

We can also discuss the acquisition and use of resources by tow sets of relatioships as synergy and opportunity cost.

Let first of all define what we mean by synergy. It means that when you combine the actions of two resources such that their total effect would be greater than when they had acted independently. Therefore, it is incumbent on managers to take decision that when they sum up the actions of the decisions should be greater than when he had taken them individually. If you decide to add financial resources to your business, such that when you are able to buy new technology-related equipment, both your business and human capital will increase. It means that the equipment the equipment so bought will bring improvement in the performance of your workers, their efficiency and increase in output.

A change in resources should ripples through the business, such that any change in your resources decision that does not bring change should be abundant. The change should affect your physical resources, and enhance the productively of the human resources. This should apply to all your decisions in business, that a change in one aspect of the business should affect he other sector directly or indirectly. Let take for instance, the National Open University of Nigeria as example, if the university decides to have her course developers well trained, it means that they will produce standard course guide for the students who will study and have a good knowledge of their studied discipline. In that way more students will be encouraged to enrol into the university's programme to study. This example illustrates the interrelated nature of resources.

Increase in one resource may increase the capacity of another resource. This, therefore, encourage managers to look up for ways to build synergy and make better decisions with in their businesses.

The second relationship is the opportunity costs and Trade-offs. As seen in synergy that the acquisition of one resource makes another resource more productive, yet the acquisition of resource requires trade-offs. This is a useful concept which means giving off the benefit that would have be derived from the resource to use the other one. For instance, you decided to use your resource to buy more computers for your business centre rather than to buy a car. Therefore, the opportunity cost of the computers is the car you could not buy.

The concept of opportunity cost is very important for managers of business need to understand and trade-offs, when considering acquiring and use new resources. Managers need 5o weight between the opportunities and see which contributes the greater to the success or growth of the business.

SELF ASSESSMENT EXERCIS 1

1. Mention and discuss the importance of opportunity cost and trade-off in business.

3.2 THE FLOW OF RESOURCES

The activities of business create room for movement into and out of the business as a way of acquisition and use of resources. For instance, when a business buys raw material from suppliers these raw material moves into the business for operation, in turn money leaves the business in form of payment to the supplier. So also when new staffs are employed into the organization, the staff size increase but something has leaves the organization, money in form of salaries for the new staffs.

This movement seems to be a vicious circle, as staff, material, and equipment are brought into the business; they produce products which are then sold to consumers. In this movement, goods leave the organization and in turn money comes into the organization as payment for the goods. The process of resources moving into, through, and out of the firm is a dynamic and continual process but managers need to be careful that these movements add value to the organization.

THE RIGHT MIX OF RESOURCES

Though at times, the amount of resources a business needs might be a problem, but the most important and challenging is having the right resources in place at the right time. There is the need to move some resources to other places to achieve the desire goals, but some fixed or physical resources might not be easy to move or transfer to another place. Even human resources sometimes exhibit this immobility. For instance, you have your business poles apart, let say one is in Jos and another is in Abuja. Now when the Abuja unit of the business is prospering and you need to shift some staff from Jos branch to Abuja. This might exhibit some difficulties because either that the staff would have accommodation problems or they would not want to leave their families and so they are reluctant to move. Thus, in this case, the firm has more than enough human resources, but they are in the wrong place, so could it be with other resources.

When managers are struggling to predict production, marketing, and distribution need, should make sure that resources available and in a proper mix to avoid surplus in one area and deficit in the other.

SELF ASSESSMENT EXERCISE 2

1 Explain how an organization or its manager can overcome the problem of resources mix.

THE RESOURCES ALLOCATION

What is paramount in business and most trying is the adequate allocation of the resources amongst the deserving units of the business. At times the resources allocation becomes more difficult than obtaining it. Thus, a business manager must have to tread a fine line, by helping one department without hurting another. In one-man business, the problem of resource allocation could still show its ugly head, when attention is being given to one sector of the business than the other.

4.0 SUMMARY

Inasmuch as it is difficult to have a perfect resources mix, it is the only way businesses need to be handled so as to make profit or experience growth. Therefore, managers of businesses should see the best resource mix as the only way to success. A careful consideration of resource acquisition, the right mix, and proper allocation would fetch managers of businesses at least mote than 60% on their way to success.

5.0 CONCLUSION

This unit has increase your horizon on the needs and ways of resource allocation in business and how the proper mix at the right place and time would bring about success. Managers of business are to see that they do not only rely on acquiring resources whether physical or financial, but how best they can mix the requirement of the business should be keyed in the case.

6.0 TUTOR-MARKED ASSIGNMENT

1. Identify and explain three ways of acquisition and use of resources.
2. Discuss how the right mix of resources can be determined?

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MODULE 3

UNIT 1 THE DEFINITION OF THE TERM FINANCIAL RESOURCES

CONTENTS

1.0 INTRODUCTION

Generally in life, we need to have something as a source or way in which we have to use to get other things in life. Therefore, in business we need to have money to start a business. It could be from us or we borrow from other sources to use for the business. Resources in business could be physical, financial, human, and information. These are necessary ingredients for a successful business.

2.0 OBJECTIVES

At the end of this unit you should be able to explain the following;

The meaning of financial resources

Cash inflow; acquiring financial resources

Cash outflow; using financial resources

Intra-firm cash flow; moving resources within the firm.

3.0 MAIN CONTENT

1. THE MEANING OF FINANCIAL RESOURCES

These are valuables that could be used to acquire other resources to aid in earning more resources. As mentioned in our introduction, physical resources are used for the purpose for which they were acquired, for instance, a building and machine. While financial resources can be used to pay salaries, buy equipment, pay for advertisements, or buy other company. It is very important for any business venture to have enough financial resources to further invest to raise or increase it prospect of growth.

Financial resources can best be discussed in the angle of its flow. This can be seen in the form of cash flow into through, and out of the business. Cash flow means the movement of cash from outside the business into the business, and out of the business. The cash inflow could be in form of sales of the business products while cash outflow could be in form of buying of raw materials, payment of salaries. Also the intra-cash flow means the movement of cash within the organization from one department to the other.

SELF ASSESSMENT EXERCISE 1

1. Explain what you understand by financial resources?

3.2 CASH FLOW; ACQUIRING FINANCIAL RESOURCES

The primary sources of cash inflow could be from the owner of the business, lenders, and customers of the business. For instance, when the sources of finance is from the owner of the business, it is called equity financing, while for those lenders it is called debt financing and the other which comes from sales, is called revenue financing.

Any money the owners invested in a company is called equity financing. In small businesses the owners may put their personal funds, raised through friends, and relatives. But in the case of bigger companies or corporations, they could raise funds by selling stock. The stockholders become co-owners of the business for the amount of money they invested through the stock the bought.

However, money loaned to the business by outsiders such as individuals, banks, or other lending institutions is called debt financing. These people are not co-owners of the business, but they are creditors which the business needs to pay back the loaned amount on a specified period with interest.

The critical source of fund is that which is raised though revenue realized by the business. This cash is generated by selling the products or services of the business to raise this revenue. This money is then use to create more goods to be sold. A successful company means more fund will be raised through its revenue which will be generated through the sell of the products. The revenue will also provide returns for the owners and the excess will be re-invested in the business.

SELF ASSESSMENT EXERCISE 2

1 Identify and explain the three sources of financing.

3.3. CASH OUTFLOW; USING FINANCIAL RESOURCES

Any amount of money that leaves the business for whatever transaction is classified as cash outflow, that is, money leaving the business. For instance, if the business buys or pays for a service rendered to it, such money is assumed a cash outflow. Generally, the outflow of fund could be for productive purpose, this cash outflow is termed outflow for operation. While those that go out for investment is called outflow for financing investment.

In business, the large hunks of its funds go out for purchases like utilities, supplies and miscellaneous item that will be used to further improve the operation of the business; others go out to pay for salaries and taxes.

When a business buys new fixed asset or pays principal and interest on loan, pay dividend to stockholders who are stakeholders in the business or returns to the owner in term of one-man business, cash has flow out from the business for investment. These monies are classified as outflow for financing investment.

SELF ASSESSMENT EXERCISE 3

1. Mention and explain the different cash outflow in business.
2. Identify the differences between cash outflow for operation and cash outflow for investment.

3.4 INTRA-FIRM CASH FOLW; MOVING RESOURCES WITHIN THE FIRM.

Cash at times might not leave the business but move from one department to the other within the organization. This movement might not involve physical cash but writing of cheque or paper work to record transactions between departments reflecting the direction of the goods which means an equivalent movement of cash in the opposite direction. The intra-firm cash flow is mostly practice by big companies which has several units within the company. This movement of cash is made possible through papers or receipts rather than cash. For instance, in company like NASCO GROUP OF COMPANIES LTD JOS, where it has more than twenty units within the company that a unit can buy the products of another unit as an input for it production. Therefore, they may not need to use cash, but rather they write cheque or receipt to settle each other. The biscuit unit buys cartons from the NASCO PACK to pack its biscuit. This transaction might not have involved cash, but there is movement of resources within the firm.

4.0 SUMMARY

Financial resources are very vital in the life of any business because it is the life line upon which all forms of businesses depend. The ways and manners in which these funds are managed are also keys in the life of the business. Money are put into the business as a way of expansion and it also move out of the business or within to keep it going and expand as you could see in the analyses above. Any disconnect in the flow of money, the organization is bound to face some crises or result to winding-up of the venture.

5.0 CONCLUSION

The cash flows are necessary whether the flow is inflow, outflow, and/or intra-firm flow; these movements keep the business better-off as each of the movement creates an increase in the business profile. Therefore, financial resource is keyed in any business since it is the only valuable that can be used to acquire other resources.

6.0 TUTOR-MARKED ASSIGNMENT

1. Identify the various cash flows and briefly explain them.
2. Discuss the difference between cash outflow for operations and for investment.

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UNIT 2 THE MANAGEMENTOF FINANCIAL RESOURCES

CONTENTS

1.0 INTRODUCTION

Financial resources are those things a company needs to acquire to use in other to acquire other resources which the company used to further produce her output for the final consumer. Financial resources could be seen to be the "Mother" of all other resources in an organization; being it physical, human, and information resources. Financial resources seem to be the basis of their acquisition in any business settings.

2.0 OBJECTIVES

This unit throws light on the meaning, needs, and ways of managing resources and the need to work in coordination with the subordinates for a better result in business.

Budgeting as a form of managing of resources
Consultation with subordinates and/or delegation

3.0 MAIN CONTENT

3.1 BUDGETING AS A FORM OF MANAGING OF RESOURCES

The acquisition of resources is one of the most important aspects of a company or business because of the trade-offs between types of resources and their resultant effect on one another. This same importance holds for the management of the resources. The best way to manage resources is to have budget for each of the units or departments in an organization such that to avoid wastage. A budget is that plan or outline of control which a unit puts in place to have a judicious use of the resources allocated to it. In an organization or business, there are mainly four or five types of budgeting depending on the target of the business. These are manufacturing budgets, research and development budgets, advertising budgets, capital equipment budgets, sales budgets etc.

Business mangers or owners of businesses work within the confines of their budgets such that there will be no wastage or shortage. A well managed budget provides good result for any business venture in term of profit and sustainability of the business. According to Barrow et al (2002), the task of the manager is to allocate and use all the resources under his or her control to meet the purposes of the organization. The successful management of all resources depends on effective planning, the strategy and the action plans.

It is not the robustness of budget but the ability of a manager to make use of the limited resources at his disposal to achieve the target of the business effectively.

3.2 CONSULTATION WITH SUBORDINATES AND/OR DELEGATION

As a manger of resources, whether physical, financial, and information, there is the need for you to consult with those who work with you to carefully analyze the needs in each area. It is not uncommon for managers of resources to fail because of their refusal to consult with their subordinates. There is no idea that is foolish or underdog, but a careful analysis of all ideas could safes and brings about progress in a business. Therefore, there is the need for consultation and sales of ideas to subordinates, who knows, the least staff of the organization might safe a collapse situation of a business with his/her idea. Business managers should not under rate the support ideas of their subordinates in managing the resources of their business.

SELF ASSESSMENT EXERCISE 1

1. Identify the need for budgeting in business outfit.

4.0 SUMMARY

Resource acquisition demands that mangers work along with many people throughout the business to acquire and use resources in the most effective and least expensive way. This is very vital because a change in one resource can affect the use of others. This is as a result of trade- offs concepts which mean using funds for one thing precludes them for others. The movement of resources involves the movement of goods, equipment people, inventory, and information from outside the business through, and back.

5.0 CONCLUSION

This unit analyses the importance of efficient and effective management of resource to any business. To get the most effective management of resources is through budgeting and delegation of authority where the various units of the business proved and work toward its success.

6.0 TUTOR-MARKED ASSIGNMENT

1. Discuss the importance of budget to a business outfit.
2. Identify the needs for delegation/consultation in running businesses

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UNIT 3 WHAT ARE BANK CREDITS

CONTENTS

1.0 INTRODUCTION

Banks' credits can be seen as the risk rating of banks or internal credit rating. Credit is the way in which banks make their businesses. It is this credit that keeps must banks in business.

When banks receive deposits from customers they do not keep these monies in their vault waiting for when the customers will come to withdraw. For the fact that there will never be a time that customers will coincidentally want to withdraw at the same time their deposits, therefore, these leverages provide avenues for transactions window for the banks to give out loans to those who want or need this idle cash balances to invest. For instance, when a customer deposits, say N1000 in his/her account, the bank might let say, give 10% interest payable on the deposit. The bank uses this money and gives out as loan to investors for say 15% interest chargeable. Now base on this analogy, the bank is making a gain of 5% profit on the N1000 deposit of the customer. In this transaction, the bank has created a credit facility and has also created money in circulation without the Central Bank of the Country minting more money in circulation.

2.0 OBJECTIVES

This unit discusses more on the following;

How banks create credits.
The importance and implication of bank's credits creation.
The destruction of the deposit by bank's credits creation.

3.0 MAIN CONTENT

3.1 HOW BANKS CREATE CREDITS.

The main activities of banks are creation of credits out of the deposits received from customers. Banks serve as intermediary between the surplus and deficit economic agents.

The most basic commodity being traded in financial markets is credit. Borrowers of funds can switch from one market to another, seeking the most favourable credit terms wherever they can be found.

3.1.1 LOANS

The principal business of commercial banks is to make loans to qualified borrowers or at least make it easier for their customers to find credit from some sources with a bank perhaps agreeing to underwrite a customer's security issue or guarantee a loan from a third party lender. Banks make loan of reserves to other banks though the federal funds market and to securities dealer through repurchase agreements.

Banks make credit available to commercial and industrial customers in the form of direct loans formally banks prefer to give out short term loans to businesses, but recently, however, banks have lengthened the maturity of their business loans to include term loan, which have maturities over one year, to finance the purchase of buildings, machinery, and equipment.

3.1.2 DEPOSITS

For banks to widen or broaden their credit creation, they draw on a wide variety of deposit and non-deposit sources of funds. It is not uncommon knowledge that the bulk of commercial bank funds, about two third (2/3) of the total funds come from deposits. This deposit comprises of demand, savings, and time deposits. The demand deposit is the commonly used which cheques are used to transact on the account, while the savings deposit is generally bear a relatively low interest rate but may be withdrawn by the depositor with no notice. And the time deposit carries a fixed maturity, a penalty for early withdrawal and usually offers the highest interest rates a bank will pay.

3.1.3 NON-DEPOSIT SOURCES OF FUNDS

One of the most significant trends in banking in recent years is greater use of non-deposit funds (borrowings), especially as competition for deposits increases in banks. Banks resort to purchasing of reserves (Federal funds) from other banks.

In recent time, banks have turned to the new style of depending on the non-deposit sources, including floating rate commercial deposits (CDS) and notes sold in international markets, sales of loans, securitization of selected assets and standby credit guarantees.

These and so many other ways the banks can create credit in the economy which helps to expand economic activities as it leads to growth.

SELF ASSESSMENT EXERCISE

1. Mention and discuss the ways banks can create credits.

3.2 THE IMPORTANCE AND IMPLICATION OF BANKS CREDITS CREATION.

The capacity of banks to create and destroy money and deposits has very vital roles for the financial system and the economy. Creation of money by banks is one of the most important sources of credit funds in the global economy – an important supplement to the supply of savings in providing funds for investment so the economy can grow faster. The money created by banks made available spendable cash balances and, therefore, unless a fast measure is taken by the regulatory authority to control the excess cash balances, it can fuel inflation. This is why the Federal Reserve System and other central banks around the globe regulate interest rates and the growth of credit principally by influencing the growth of bank reserves and deposits.

3.3 DESTRUCTION OF THE DEPOSIT BY BANKS' CREDIT CREATION.

Inasmuch as banks expand deposits and create credits by a multiple amount but they can also as well contract deposit and money by the same multiple amount. This transaction can be illustrated in a tabular form.

BANK A RECEIVES NEW DEPOSIT

Assets		Liabilities	
Required Reserves	200	Deposit	1000
Cash loan	800		
	1000		**1000**

BANK B RECEIVES NEW DEPOSIT

Assets		Liabilities	
Required Reserves	160	Deposit	800
Cash loan	640		
	800		**800**

BANK C RECEIVES NEW DEPOSIT

Assets		Liabilities	
Required Reserves	128	Deposit	640

Cash loan	512		
	640		**640**

BANK D RECEIVES NEW DEPOSIT

	Assets	**Liabilities**	
Required Reserves	102	Deposit	512
Cash loan	410		
	512		**512**

The initial deposit by bank A was ₦1000 but with the credit creation by the banks the banking system will ultimately generate a volume of deposits several times larger than the amount of the initial deposit received by Bank A.

Name of Bank	Deposits Received	Loans made	Required Reserves
A	1000	800	200
B	800	640	160
C	640	512	128
D	512	410	102
Final amounts for All banks in the System will be	**₦**	**₦**	**₦**

A depositor has withdrawn ₦1000 from a transaction account at Bank A and has decided not to place the money in another bank. Recall that behind the ₦1000 deposit, Bank A holds only ₦200 in required reserves. This means that when the deposit is withdrawn, the bank will have a net deficiency of ₦800. For Bank A to recover this deficiency, it has to sell her securities in the amount of ₦800 to increase her legal reserves by the necessary amount. The buyer of these securities has to pay for them by writing a cheque against his account in say Bank B for example; it means Bank B will loose a deposit of ₦800 and her required reserves of that ₦800 to Bank A. When you consider Bank A and Bank B together in the system a total deposit of ₦1800 has fallen. This deposit contraction has freed up ₦360 (₦200+₦160) in required reserves. There will be for the contraction of deposits in the system if Bank B is also loaned up and has a net reserve deficiency of ₦640. For Bank B to recover its reserve deficiency, it has to draw reserves of other banks. Ultimately, deposits will contract by a multiple amount as banks try to recover their reserve deficits. This system of banks trying to recover their reserves draws down the economy, even to a halt.

4.0 SUMMARY

Banks in their activities of credit creation provide loans to individuals, private businesses, and public businesses. However, this process also destroys the economy where excess cash balances could fuel inflation in the economy. On the whole, banks are the only channel through which credits are created other than the regulated authorities like central bank of Nigeria, in Nigeria case.

5.0 CONCLUSION

This unit dealt with the analyses of banks credit creations which make cash balances available at the disposal of investors and relief those with surplus balances. These activities both build and destroy the economy as the analyses portraits.

6.0 TUTOR-MARKED ASSIGNMENT

2. Mention and demonstrate how banks create credits.
3. Discuss how banks credit creation destroys the economy.

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UNIT 4 THE TYPES OF BANKS' CREDITS

CONTENTS

4.0 SUMMARY

5.0 CONCLUSION

6.0 TUTOR-MARKED ASSIGNMENT

7.0 REFERENCES/FURTHER RADINGS.

1.0 INTRODUCTION

Any bank that performs the function of accepting deposits and advancing loans to or creating credits, this is the function that differentiates commercial banks from other financial institutions and that why they are termed commercial banks. This is a bank that opens all forms of accounts to allow deposits. For instance, its opens current account and accept cheques on them, savings, joint accounts, corporate account, minor accounts, and accept valuables for safe-keeping.

2.0 OBJECTIVES

This unit X-rays in details the components activities of banks' credits and their operations in the economy. It also explains in details the following sub-units as it affects businesses.

Loans and Advances
Equipment leasing
Inter-bank float – call money
Certificate of deposits
Banker acceptance
Commercial Paper
Bill discounted
Promissory note

3.0 MAIN CONTENT

3.1 LOANS AND ADVANCES

Banks give loans and advances to their customers at an interest higher than the one they pay on deposits. It is the differences between interest charged on loans and advances and interest paid on deposits that the banks make their profits. When banks advanced loans to their customers, the open an account in the name of the borrower and do not pay them cash but allow them to draw the money using cheque. When they grant loans or an overdraft, the bank has created credit. It is not uncommon for people to see loans and overdrafts to mean the same thing. Loan is an amount which your bank allows you withdraw when you must have shown your intend by applying and it is approved. It is not necessary that you must have money in the account; you may be required to produce a security or collateral, the loan could be for one year or more. An overdraft is that which your bank allows you to withdraw money on your account above your balance and could be for short period of one to three months; in this case, collateral is not needed as a security for the loan.

3.2 EQUIPMENT LEASING.

This is a method of financing which the bank do on behalf of their customers, in which equipment or other fixed assets will be bought by the bank for the customer who has title to the equipment or asset without paying one kobo. The (leasor) which is the bank agrees with the (leasee) which is the user of the equipment or assets to be paying an agreed sum of money (know as rental) for a determined period of time. Normally, an agreement is therein drawn up between the leasor (bank) and the leasee (user of the equipment) such that the terms of the contract and the amount of rental to be paid at a given period are included. It could be yearly or any other agreed period. The total cost of the equipment can the bank interest will form part of the contract terms.

3.3 INTER-BANK FLOAT – (CALL-MONEY).

This is a short term money market which allows for long financial institutions such as banks, mutual fund, and corporations to borrow and loaned money at inter-bank rates. The loans in the call money market are very short, usually lasting no longer than a week and are often used to help banks meet reserve requirements.

This form of loan will not be advisable to be used by businesses or investment companies their yield will take longer period. This is because of the short nature of its maturity. It can only be used by banks as mentioned above, to meet the immediate financial trap of the bank. The lender of this fund raises or earns some interest base on the bank market5 interest rates.

3.4 CERTIFICATE OF DEPOSITS

A certificate of deposit (CD) is a time deposit with banks. They are generally issued by commercial banks but they can be bought through brokerages. They bear a specific maturity date, between three months to five years, a specified interest rate and can be issued in any denomination much like bonds. Like all time deposits, the funds may not be withdrawn on demand like those in a cheque account.

Certificate of deposits offer slightly higher yield than Treasury bills because of the higher risk involved. Of course, the amount of interest you earn depends on a number of other factors such as the current, interest rate environment, how much money you invest, the length of time and the particular bank you choose. The main thing you need to consider when buying certificate of deposit is the difference between annual percentage yield (APY) and annual percentage rate (APR). The APY is the total amount of interest you earn in one year, taking compound interest into account while APR is simply the stated interest you earn in one year without taking compound interest into account.

3.5 BANKERS' ACCEPTANCE

This is another short term credit investment which is created by the non-financial firm and guaranteed by a bank to make payment acceptances are traded at discounts from value in the acceptance on the secondary market. Corporations handle Bankers' Acceptances as a negotiable time draft for financing their businesses. This is especially useful when the credit worthiness of a foreign trade partner is unknown. For instance, Acceptance sells at a discount from the face value will be as follows;

Face value of bankers' acceptance	N10, 000,000
Minus 2% per annum commission	200,000
Amount received by exporter	9, 800,000

The advantage of a bankers' acceptance is that it does not need to be held until it is mature; it could be sold off in the secondary markets where investors and institutions constantly trade Bankers' Acceptances.

3.6 COMMERCIAL PAPER

Most corporations and business investors try as much to avoid borrowing short term money from banks, this desire to avoid the short term credit from the banks led to the widespread popularity of commercial paper. Commercial paper is an unsecured short term loan issued by a corporation to the recipient at a discount reflecting current market interest rates. It is usually mature within one to two months on the average. This facility is good for fast moving businesses, like Petroleum Dealers, and other fast moving businesses.

3.7 BILLS DISCOUNTED AND/OR TREASURY BILLS

Treasury bills are short term loans that mature between three months and one year. They are normally purchase for a price that is less than their face value, when they mature. They percentage of the bill when matured is 2% of whatever amount you could have bought that is, if you bought a 90 days Treasury bill and hold on to it until maturity. Treasury bills or discounted bills are the most popular money markets instruments that are affordable to individual investors because they are issued in smaller denominations and are considered risk-free. The only disadvantage here is that, because of the low risk, the return is not high, but they are exceptionally safe.

3.8 PROMISSORY NOTES

A promissory note is an undertaking written by a borrower of funds from a financial or corporate body promising to pay back the borrowed fund at a specified period and interest. It is a short term loan which is normally for a very short period of time. This is quiet different from the normal (I.O.U) which people could take in their places of work or from friends. The I. O. U normally does not carry a specific period of repayment and also it does not carry a rate of interest as in the case of a promissory note.

4.0 SUMMARY

Banks and other financial institutions are the surest ways through which businesses could be financed. There are all sorts of financial assistances that one could approach the banks and other financial institutions or corporate bodies once the conditions are made, finance is sure. The ways or mode of accessing this investment portfolios are documented and cannot be changed mid-streams of the contract, as it would have been in the case of sources from friends or relations. Some times, funds are better sought for at corporate bodies rather than banks.

5.0 CONCLUSION

This unit analyses the different ways and mode of raising funds to finance any type of business, proprietorship, partnership, and public liability company. The unit provides the available sources of funds in both financial and corporate bodies which credits could be created to finance businesses.

6.0 TUTOR-MARKED ASSIGNMENT

1. Identify and discuss four types of credits created by banks.
2. Mention and discuss the difference between a promissory note and an I. O.U note.

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Unit 5 THE SIGNIFICANCE OF THE BANKS' CREDITS TO THE GROWTH OF FIRMS.

CONTENTS

1.0 INTRODUCTION

Commercial banks are known for the provision of loan and advances to both private and public sectors of the economy. This, they do as a way out of the menace of financial trap which befall all the economic agents.

Credits of the commercial banks are important to businesses for it makes possible the financing of the agriculture, commerce, and industrial activities of the nation. Production, transportation, wholesale, and retails activities are made possible through financial aid from credits of the commercial banks to the final consumers.

2.0 OBJECTIVES

This Unit throws light on the activities of commercial banks in the areas of extension of credits to the private and public sectors of the economy. It also explains the working of the credits in terms of its redemption, repayment, to the bank.

Extension of credits to the private sector
Extension of credits to the public sector

3.0 MAIN CONTENT

3.1 EXTENSION OF CREDITS TO THE PRIVATE SECTOR

The deposits, loans and advances provided by banks benefit businesses in many ways; first chequing account, they are as good as cash in themselves, they make it much easier to buy goods and services and therefore help both consumers and businesses. There is no more carrying of bulky cash around for transactions.

The loans and advances from banks help consumers to improve their standard of living by borrowing money to purchase cars, houses, and other expensive consumer goods that they otherwise could not have afforded. This also in turn relief producers of their inventory, hence enhance business activities. Loans and advances help businesses finance plant expansion and production of new goods, and therefore increase employment and economic growth. Since banks want their loans and advances paid, they choose borrowers carefully and monitor performances of the company's managers closely. This helps ensure that only the best projects get financed and that companies are run efficiently, and this creates a healthy, efficient economy.

3.2 EXTENSION OF CREDITS TO THE PUBLIC SECTOR

In the public sector, the government uses the Central Bank of Nigeria (CBN) to direct the commercial banks to provide about 50 per cent (50%) of their loan- able funds to some specific sectors of the economy, like Agriculture, Manufacturing and none oil exportable crops. Government also obtain banks' loans and advances to provide essential services like, water, electricity, roads, health, and the provision of security to all the citizenry.

The government also allows the banks to participate in some government ventures by equity participation on the basis of (P3) Public-Private Partnership which also boost the economic activities in the country. Government in its bid to increase economic activity in the country serves as a guarantor to economic agents through the Guarantee Bank Scheme.

4.0 SUMMARY

Banks' loans and advances are seen as one of the vital contributions banks make in the development of both the private and public sectors. Apart from increasing economic activities, it also empower the individuals to consume those expensive goods which ordinary would not have consumed. On the whole, activities are heightened in the Manufacturing, Commercial, and Transportation sectors and therein boost the economy of the country.

5.0 CONCLUSION

This Unit highlighted the contribution of the banks loans and advances to the growth of not only the firms but the economy as a whole. The unit discussed the contribution of banks' loan and advances to the private and the public sectors. It also showed the importance of banks' credits as a tool for economic growth.

6.0 TUTOR-MARKED ASSIGNMENT

1. Identify and discuss the contribution of banks' credits to the private and public sectors.
2. Mention and explain how bank credits bring about growth in businesses.

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