THE ROLE OF ACCESS TO FINANCE IN THE ESTABLISHMENT OF NEW BUSINESS VENTURES

AWELE LAURETTA IKOBI-ANYALI*
Research Fellow, Nigerian Institute of Advanced Leal Studies (NIALS) Abuja, Nigeria.

Abstract
Access to finance essentially deals with how business owners or promoters intend to raise finance to fund their business. Thus, the concept of access to finance becomes very crucial in setting up a new business venture which is profit oriented. World over, a dynamic legal structure determines to an extent the success of a business. Considering that Nigeria is going through a recession, investors both old and new are finding it difficult to access funds. This paper focused on how new enterprises in Nigeria will structure their enterprises to enable them access funds. In funding a new enterprise, a choice is often made between debt or equity finance, each having its various advantages and disadvantages as discussed in the paper. The paper considered how the investor can strike a balance between equity and debt finance. The paper highlighted the various legal structures for business entities in Nigeria such as Companies, Partnership, Limited Liability Partnership and the Business name models. However, the paper discovered that despite the disclosure regimes, companies have a wider recognition owing to their ability to access fund through equity and debt finance which include debt securities which are tradeable. The paper argued that this is impossible for a partnership to embark on. The paper also highlighted the advantages and disadvantages of the various business models when accessing funds and arrived at the conclusion that incorporated companies are more at advantage in borrowing and raising money. The paper recommends amongst others that more states should enact their own Partnership laws and make the Limited Liability Partnership model popular.
Keywords: Access to finance, debt, equity, partnership, incorporated companies

1.0 Introduction

New business ventures are usually faced with the challenge of sourcing for funds. No lender or investor will be willing to lend money or invest in a new enterprise without any form of security or participation in the business. More so, most entrepreneurs do not have the idea of how much fund is needed to finance an enterprise. When a company's investment policies require external finance, a choice is usually made

*Awele Lauretta Ikobi-Anyali L.L.M (Corporate and Financial Law), (University of Glasgow) Research Fellow Nigerian Institute of Advanced Legal Studies(NIALS) Abuja. Email address: aweleanyali@gmail.com

between equity or debt financing[1]. In the 19th Century, limited liability of shareholders was seen as corporations' most precious characteristics and one of the most effective legal inventions made so far.[2]The introduction of the limited liability concept brought about various factors such as access to finance, especially the equity ownership interest which may influence the decision of a promoter or business founder in the legal structure a new enterprise will undertake.[3]

Ordinarily, there is no valid business idea that cannot be funded. It is a matter of structuring the enterprise and knowing where to get the funds required.[4]A new business may decide to opt for one of the following business models, namely, a limited liability company[5] which may either be a private[6] or public company,[7]a partnership, a limited liability partnership or a business name.[8]Apart from corporations registered under one of the options listed, Small Medium Scale Enterprises (SMEs)abound and are usually funded through loans from banks and other financial institutions. [9]Unfortunately, records indicate that the performance of SMES in Nigeria has not justified the establishment of this plethora of micro-credit institutions.[10]

---

[1]I.G Macneil *'An introduction to the Law of Financial investment'*1st edn.(Oxford and Portland 2005) P. 208

[2] M.N Nelson, *'Readings in Corporation Finance'* (Ronalds Press Company Newyork 1926) p.23

[3] J. Pratt ' *Financial Accounting in an Economic Context'*(7thEdn. Wiley Newyork 2008) p.794

[4]http://www.bizoffice.com/*why-financing-is-important-to-your-business*/#sthash.bwGMKMga.dpuf last accessed on 26/9/2016

[5] Companies and Allied Matters Act, CAP C20 LFN 2004 (Hereinafter referred to as CAMA) Section 21

[6]*Ibid*, Section 22

[7]*Ibid*, section 24

[8]*Ibid*, Section 19

[9] Before a business is registered under an SME and eligible to any funding, it must be registered under the CAMA and must comply with some provisions of the CAMA such as filing of Annual returns, financial statements and comply with some applicable tax regulations and laws. This is as provided under rule 5.0 of the Small and Medium Enterprises Equity Investment Scheme (SMEEIS) Revised Guideline which is an Initiative of the Bankers Committee.

[10]K.K Ogujiuba,F.K Ohuche and A.O Adenuga, 'Credit Availability to Small and Medium Scale Enterprises in Nigeria: Importance of New Capital Base for Banks – Background and Issues'. A study reported in Guardian Newspaper of November 26 2001 identified poor access to finance as the most critical constraint on small and medium scale enterprises in Nigeria. The Report stated that 50 percent of the surveyed enterprises received external finance while 79 percent indicated lack of financial resources as a major constraint. The micro-credit institutions includes Nigerian Bank for Commerce and Industry (NBCI), National Economic Reconstruction Fund (Nerfund) Micro Finance Banks(MFBs), and the Nigerian Export and Import Bank (NEXIM). http://s3.amazonaws.com/academia.edu.documents/31204923/0411002.pdf?AWSAccessKeyId=AKIAJ56TQJRTWSMTNPEA&Expires=1475757794&Signature=E2HjwG%2FkhC4PvePF8HGmihKnD3c%3D&response-content-disposition=inline%3B%20filename%3DCredit_Availability_to_Small_and_Medium.pdf ,p. 6 last accessed on 4/10/ 2016

There are three main sources of finance with which a company can finance its operations, they are, shares issues (equity),debt and retained profits.[11]However, the paper will focus on debt and equity finance.

The aim of the paper is to examine how access to finance can influence the choice of legal structure a business will undertake. The paper will therefore look at the various ways of raising finance, the forms of business enterprises a business owner or promoter can structure in Nigeria. The paper will further examine how such businesses can access finance and the limitations of the various business models when it comes to accessing finance. The paper will also put forth other factors that are salient to the type of registration model a company will undertake. This will be followed by the conclusion.

1.1 Access to Finance and financing

Financing structures, particularly the mix between internal and external financing, reflect in part the ease of firms' access to finance.[12] Although there is a perceived difficulty in defining the term 'access to finance', it is commonly referred to as "the availability of supply of quality financial services at reasonable costs."[13] Financing refers to the approach in which enterprises fund the ventures that form their business.[14] It is trite that enterprises or businesses as a whole thrive in investment and this reliance is on the finances that are available to it. The paper posits that access to finance is the ability to know how and where to raise funds for a business enterprise which is determined by the nature, size and the goal of the business.

Debt and equity are the two major forms of financing an enterprise may adopt to fund its business. Lenders, such as banks, partners and family members can supply debt capital, which are usually repaid while investors supply equity capital, which entitles them to shares of stock and partial ownership in the company. Notwithstanding, both types of capital go without risk. Before discussing in details the concept of equity and debt as a source of financing a new enterprise, it is pertinent to highlight the advantages and disadvantages of the two sources of finance.

According to Gullifer and Payne, there are far more varieties in the debt finance available to most companies as compared to equity financing[15], the varieties are in

[11]L. Gullifer and J. Payne, '*Corporate Finance Law Principles and Policy'(*Hart Publishing, Oxford2011) p.8

[12]StijenClaessens and Konstantinos Tzioumis, 'Measuring Firms' Access to Finance'(World Bank, May , 2016) 8 worldbank.org/FINANCIALSECTOR/Resources/ClaessensEtal_MeasuringFirmAccess.pdf last accessed on 26 /9/ 2016

[13]*Ibid*

[14]Macneil (n1) 207.

[15]Gullifer and Payne (n11) 20

forms of bank loans, debentures, and debt securities. The process of selecting the most appropriate debt financing option will depend on the size and nature of the enterprise, current financial position, the nature of its assets, the reason the finance is needed and the nature and requirement of the lender.[16]Debt finance is not only restricted to corporations but extends to partnerships, business names and limited liability partnership while in equity financing, there is only the issue of shares, the only variety is in the type or class of shares to be issued such as ordinary[17]or preference shares.[18]Furthermore, in equity financing, the shareholders have a significant role since they have power to control the directors in relation to the issue of new shares[19]while debt financing is a corporate decision taken solely by the directors.[20] This infers that debt financing option is easier to perfect. Also in equity financing, when a company becomes larger, and more finances are needed, this may no longer be satisfied by the existing shareholders as bringing in more equity owners through the issuance of shares will dilute the profits and rights of the existing shareholders. Existing shareholders are always reluctant to admit new shareholders.

One particular advantage of debt financing through debt securities over equity securities is that the interest paid on debt securities is tax deductible for the company unlike dividends which cannot be deducted, this makes debt a much cheaper option than equity to a large extent.[21] These are some of the issues that a founder/promoter should consider before startup.

2. 1 Choice of Legal Structure and Factors Relevant for the Choice of Legal Structure

2.1.1Incorporated Companies

The most important unit of business which has been popular since the 19th century and a catalyst of modern economic activity is the incorporated company or corporations. This is as a result of its legal personality, limited liability, perpetual succession, the opportunity for investment, raising capital, strict legal control and protection of members and creditors. This makes the registered company play a vital role in the development of the national economy.[22] Other factors are: separation of

[16]*Ibid*
[17] CAMA, Section 143
[18]Section 122
[19] This usually takes place during annual general meetings or Extra ordinary general meetings of the company to which members and directors are given notice to attend together with the agenda of the meeting stated on the notice, once a resolution is reached and approved with respect to any share issue, such information is passed to the Corporate Affairs commission and appropriate filings are made to that effect.
[20]Gullifer and Payne(n11) 20
[21]*Ibid* 33
[22] O. J. Orojo,' *Company Law and Practice in Nigeria'* (3rdEdn Lagos 1992) p. 12

ownership from professional management, access to external equity investment, access to external debt finance, preference for privacy over disclosure, tolerance of legal controls over subscribed capital and transferability/liquidity of sharesin the era of globalisation and modernisation.[23]

The most famous feature of a limited liability company which differentiates it from all other legal structure is the doctrine of legal personality which was established in the case of *Salomon v Salomon*[24]where the court held that:
"the company is at law a different person altogether from the subscribers to the memorandum; and although it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustees for them, Nor are the subscribers as members liable , in any shape or form, except to the extent and in the manner provided by the Act"

This rationale was also enunciated in the Nigerian case of *Marina Nominees Ltd v F.B.I.R*[25]and further encapsulated in Section 37 of the Companies and Allied Matters Act[26]which provides for the effect of registration of a company as from the date of incorporation. Although a company is a legal person under the law, it is of course an artificial person.[27]It can only act through the officers of the company such as the directors and the secretary duly appointed by members at incorporation or in a general meeting.

An incorporated company may take the form of either a company limited by shares, limited by guarantee or an unlimited company[28]which may be a private or public company. However, companies limited by guarantee and unlimited companies are not commonly chosen as legal structures by individuals setting up a profit-making organisation. For companies limited by guarantee, they do not provide a simple mechanism for the sharing of profits because they are member owned and not-for-profit. This may not be a good legal structure for a new enterprise, while unlimited companies forgo the benefit that is often regarded as providing the greatest advantage to the corporate form which is the limited liability principle.[29]

[23]In the era of globalisation, uncertificated shares are now being adopted instead of the paper shares and most capital markets have embraced this.
[24] (1897) A.C 22
[25] (1986) 2 NWLR where the court held that …an incorporated company is a separate legal entity which must fulfill its own obligations under the law
[26]Cap C20 LFN 2004
[27]Orojo(n22) 81
[28] CAMA, Section 21
[29]Gullifer and Payne(n10) 8

Considering that an incorporated company may take the form of a private or public company,[30]it is expedient to know that a private company have limited disclosure, less control over capital and is restricted by its articles from transferring its shares[31], members are not required to exceed fifty (50)[32]and it does not invite the public to subscribe to its shares unless authorised by law.[33] These restrictions may affect access to equity finance by a private company thereby limiting the company's access to finance. A public company on the other hand have enhanced disclosure and traditionally invites the public to subscribe to its shares thereby making for an unrestricted access to finance, while also possessing control over capital and adhering to more regulatory standard, going public and getting listed on a stock exchange for example the Nigerian Stock Exchange (NSE). This arrangement further opens the company to more investors and access to capital to fund its business. For a new enterprise, it is advisable to engage the private company model because even if you cannot access equity shares (ie equity shares through the Nigerian stock exchange) owing to the legal and regulatory constraints, debt finance through a bank loan is readily an available option to kick start the business [34]while the business awaits authorisation to issue its shares to outsiders. Albeit, in Nigeria, interest rates on bank loans are high ranging from28 to 32 percent depending on individual banks as opposed to the interest rate obtainable in countries like Ghana whose lending rates are between 18.5 to 23 percent[35]and United Kingdom at1.25 percent in September.[36]

This loan rate discourages new enterprises that are supposed to be focused on the objectives of their incorporation to make profit and stay in business instead of focusing on paying back loans to avoid the banks from taking over the management of the business or worse, the enterprise collapse, especially now that the country is going through recession and the free fall of the Naira against international currencies. Be that as it may, the Federal Government of Nigeria in partnership with States and or some of her parastatals have in place schemes, policies and incentives at low interest rate such as the 200 Billion Small and Medium Enterprises Credit Guarantee Scheme

[30] CAMA ,Section 22 and 24
[31]*Ibid,* section 22(2)
[32] *Ibid,* section 22(3)
[33]*Ibid,* 22(5) (a) (b). Private companies can also convert to public companies in accordance with section 50 of CAMA 2004
[34]With the company's assets and properties serving as a collateral for the bank or lender
[35]http://www.ghanatrade.gov.gh/Latest-News/bank-of-ghana-rates-commercial-banks-interest-charges.htmllast accessed on 6/10/ 2016
[36] The United Kingdom bank lending rate remained unchanged at 1.25 percent in September from 1.25 percent in August of 2016. One can see that the cost of doing business in Nigeria is higher than some other countries and this may affect investors from coming to invest in Nigeria http://www.tradingeconomics.com/united-kingdom/bank-lending-rate last accessed on 7/10/ 2016

(SMECGS) of the CBN established in 2010[37]and The Small and Medium Industries Equity Investment Scheme (SMIEIS) an initiative of the bankers' committee approved in December 1999[38] and sometimes moratorium to aid small scale businesses and or entrepreneurs.

One of the main features of corporations is the limited liability doctrine. The limited liability doctrine limits claims of corporate creditors to the corporate assets and prevents creditors from reaching the personal assets of shareholders. The paper posits that the listed characteristics of the public companies such as enhanced disclosure, access to public capital markets ,liquidity, enhanced governance requirements makes it more efficient and will enable investors make informed decisions to invest in the business or not. Flowing from the above, it could be said that a company limited by shares is more business friendly if a founder decides to choose the incorporated companies legal structure.

2.1.2 Partnership

"Partnership is the relation which subsists between persons carrying on business with a view to profit."[39]The Companies and Allied Matters Act which is the extant law guiding companies and businesses in Nigeria describes a partnership as "a firm which means an unincorporated body of two or more individuals or one or more individual and one or more corporations, or two or more corporations, who or which have entered into partnership with one another with a view to carrying on business for

[37] The Scheme shall have a fund of N200 billion to be wholly financed by the Central Bank of Nigeria, managed by the CBN and responsible for the day to day running of the scheme. For the purpose of this Scheme, a Small and Medium Scale Enterprise (SME) is an enterprise that has asset base (excluding land) of between N5million –N500 million and labour force of between 11 and 300. Maximum Loan amount is N100 million which can be in the form of Working Capital, Term Loans for refurbishment/equipment upgrade/expansion, overdrafts, etc.. However, trading is not accommodated in this scheme, it also excludes public companies.
.https://www.cbn.gov.ng/Out/2010/publications/guidelines/dfd/GUIDELINES%20ON%20N200%20BILLION%20SME%20CREDIT%20GUARANTEE.pdf last accessed on 7/10/ 2016)

[38] The initiative was in response to the Federal Government's concerns and policy measures for the promotion of Small and Medium Enterprises (SMEs) as vehicles for rapid industrialisation, sustainable economic development, poverty alleviation and employment generation. The Scheme requires all banks in Nigeria to set aside ten (10) per cent of their Profit After Tax (PAT) for investment and promotion of small and medium enterprises. The 10% of the Profit After Tax (PAT) to be set aside annually shall be invested in small and medium enterprises as the banking industry's contribution to the Federal Government's efforts towards stimulating economic growth, developing local technology and generating employment. However, enterprises that engage in trading activities and financial activities are excluded from accessing this fund and it excludes public companies.
http://www.cbn.gov.ng/OUT/PUBLICATIONS/GUIDELINES/DFD/2006/REVISED%20SMEEIS%20GUIDELINES.PDF last accessed on 7/10/2016

[39]Section 1 (1) English Partnership Act 1890. Suffice to state that partnership in Nigeria is still very much guided by the English Act, however Lagos State has enacted its own partnership law .see also section 3(1) Partnership Law of Lagos state 2009

profit."[40] Although, the law regulating this form of relationship between partners and outsiders in Nigeria is found in the English Partnership Act 1890, some states in Nigeria have enacted their own partnership laws.[41]Partnership can also be seen as a contractual relationship which results from a contract. The contract here as espoused by Jessel MR in *Pooley v Driver*[42]means a contract for the purpose of carrying on a commercial business, that is a business bringing profit, and dividing the profit in some shape or another between the partners.[43]

Although the term "profit" distinguishes partnerships from non-business associations such as the incorporated trustee, a partnership can only come into existence by an agreement between the partners(agreement is a precondition to partnership)[44] Such an agreement may be written, oral or inferred from conduct in whole or in part. The partnership agreement also provides for the constitution which governs the partnership and the relationship between the partners. From the foregoing, it appears that a partnership relationship can arise only by mutual consent, which may be express or inferred from parties' conduct. The personal nature of partnership means that a partner has agreed to associate with his co-partners and no-one else; no new partner can be introduced without the consent of all the partners, and getting the consent of all partners may be challenging.[45]Moreso, in carrying on partnership under a business name in Nigeria, such a name is required to be registered under Part B of the CAMA 1990. CAMA 1990 provides that such partnership must not exceed twenty (20) members.[46]However, partnerships for the purpose of legal practice and for accounting are the exceptions to this provision.[47]

It is pertinent to note that in English law,[48] unlike the incorporated companies, a partnership does not have a separate legal personality from its partners, therefore, a partnership firm cannot acquire rights nor can it incur obligations, it cannot hold property. The rights and liabilities of a partnership are the collection of the individual rights and liabilities of each of the partners. The firms' name is a mere expression, not a legal entity which is known as the "aggregate" approach to partnership.[49] Under

[40]CAMA, Section 588
[41] Lagos State Partnership Law 2009
[42] (1877) 5 Ch D 458, 472
[43] 'The Law commission and the Scottish Law Commission' (LAW COM No 283) (SCOT LAW COM No 192) Partnership Law Report on a Reference Under section 3(1) (e) of The Law Commissions Act 1965 p. 6
[44]*Ibid*
[45]*Ibid*
[46]CAMA ,Section 19(1)
[47] Ibid, Section 19(2)
[48] Which is still applicable in Nigeria, however states like Lagos state now have its partnership law, Lagos Partnership Law 2009
[49]Op.cit(n43)

Scottish law, however the partnership firm enjoys the separate legal personality doctrine.[50]The Nigerian law adopts the English position, this is because the English Partnership Act is still applicable in Nigeria.

Considering the challenges posed today by international competition it is observed that the general form of partnership is losing its demand because of its inherent disadvantages which are unlimited liability and legal consequences as the firm is not a body corporate together with lack of adherence to corporate governance code and disclosure regimes. Therefore the need has been felt to provide for an alternative form of business structure that could combine the flexibility of a general partnership and the advantages and privileges of a limited liability company at a low compliance cost.[51]One of the basic advantages of the partnership legal structure is that it is easier to register unlike the incorporated companies, there is no disclosure regime and the partners are accessible, but for its unlimited liability nature.

2.1.3 Limited Liability Partnership (LLP)

Limited liability used to be associated with corporations as can be seen under Section 21 CAMA 1990 and section 7 of the UK Companies Act 2006.[52] However, this concept has found its way into a partnership model known as the limited liability partnership thereby making the LLP to enjoy the benefits of limited liability and legal personality thereby removing joint liability on partners as it is under the general partnership. The effect of this arrangement is that the LLP is now subject to a regulatory regime similar to that imposed on companies, such as public disclosure requirements and insolvency procedures under the English Law. Initially in the UK, the LLP model was only used by professional firms such as law firms or accounting firms. Owing to the opinion in the consultation process against restricting LLP to only professionals, the Limited Liability Partnership Act (LLPA) 2000 finally devised the LLP as a body corporate that can be used by not only professional firms but also by small enterprises as an alternative to the ordinary partnership and private company.[53]
In Nigeria, the concept of LLP is not popular as the English Partnership Act of 1890 is still widely applicable in Nigeria. It is no news that the English Partnership Act 1890 did not make provision for the LLP structure. However, the Partnership Law of Lagos State 2003 which is the precursor to the 2009 law [54] in its Part Four (4)

[50] *Ibid*
[51] M. S. Asghar, ' Limited Liability Partnership in Pakistan: An Overview' SSRN-id2792534.pdf last accessed on 27/9/2016
[52] Companies Act 2006 (UK)
[53]Wei, Chuyi Partnerships with limited liability and creditor protection in China: a comparative perspective from the UK and US. PhD thesis(2015) http://theses.gla.ac.uk/6637/7/2015WeiPhd.pdf last accessedon 24 /9/2016
[54]Partnership Law CAP P1, 2009

provides for limited liability partnership as a form of business model in Lagos state.[55] In Lagos state, limited Partnerships have to be registered at the limited partnership registry of Lagos State which became operational with the appointment of a Registrar of limited partnerships by the Lagos State Government in June 2002.[56]

Just as it is in the UK, the essence of including the LLP into the Lagos law is to enjoy the benefits that accrue to limited liability companies[57]which limits their liabilities to the public. To this effect, partners that register their businesses under this law enjoy reduced responsibility in the event the partnership breaks up or the venture fails.[58]Furthermore, an LLP can access debt finance through the floating of charges. The LLP could be said to be a hybrid of incorporated companies and partnerships. From the foregoing, it could be said that LLP as a legal structure which limits liability of partners is available in Lagos state in Nigeria and promoters who want to establish businesses in the form of LLP can now register same in Lagos state and may have branches in any part of the country of choice subject to the partnership law of Lagos state.

2.1.3 Business Name

Business name refers to the name or style under which any business enterprise or venture is carried on whether in a partnership or as a sole business man.[59]This form of business model must also be registered under section 572 of CAMA 1990.Individuals may decide to carry out a business in his their own name, this need not be registered. However, when individuals and partners decide to carry on businesses with business names other than their own names, to give some form of protection to such individuals or partners, such names are required to be registered[60]under Part B of CAMA 1990. Section 572(1) provides for the conditions of such registration. A business name can be registered as a sole proprietorship or as a partnership or may not be registered at all.[61] This form of business is usually advised for start-up enterprises because it requires less capital for start-up and is less cumbersome to register but has unlimited liability. It is mostly used for a one man business usually small scale enterprises.

---

[55] 'A Review of Limited Liability Partnership under the Partnership Law of Lagos State 2009, April 2013' http://www.spaajibade.com/resources/a-review-of-limited-liability-partnerships-under-the-partnership-law-of-lagos-state-2009/ last accessed on 24 /9/ 2016

[56] Limited Partnership -A focus on Registration Under the Lagos State Partnership Law by Off Shore Entities' http://www.dcsl.com.ng/data/content/_1357638361_TN84X70FE7.pdf last accessed on 26 /9/ 2016

[57] Section 75(3) Partnership Law of Lagos State 2009

[58]Chuyi (n43)

[59] CAMA, Section 588 (1)

[60]Orojo (n22) 537

[61]CAMA,Section 572(2)

3. 0 Financing Options/ Accessing finance through Equity and Debt Finance

3.1 Equity Financing

Equity financing refers to 'financing through the issue of share capital'[62]through a stock exchange. This form of financing can only be considered by a public company limited by shares, which must have at least an issued share.[63]As the definition above implies, it means that it is only companies who have a share capital that can access funds through equity finance. This simply means inviting the public to subscribe to the shares of the company thereby becoming members or shareholders of the company. However, under CAMA 1990, private companies who also have issued share capital at incorporation may not offer to the public any of its shares.[64]

When a business owner sets out to structure a business, the capital required may exceed what the original shareholders can or wish to contribute, this may place limits on the company's development if further sources of funding are not tapped.[65] To allow the company have access to outside funds and investors who can actively participate in the company, an Initial Public Offering (IPO) is usually launched. Public Companies not only offer their shares to the public but raise external equity finance through an IPO whereby shares of a company are sold to private investors and consequently traded on a stock exchange.[66] Most companies will raise external equity finance only once at the time of IPO, thereafter they tend to rely upon retained earnings and debt either from banks or through the issue of bonds to finance their operations.[67]Therefore, it could be said that companies consider IPOs to raise funds for business since the IPO involves the issue of new shares and funds realised from the public offering are received by the company. IPOs are not only for new

[62]Mac Neil, (n1) 208.
[63] CAMA, section 117
[64] Except this is authorised by the court in accordance with CAMA section 22
[65]Gullifer and Payne(n10) 408
[66]An IPO is difficult or rather impossible for a new enterprise to embark on considering the listing requirements and the IPO process . To qualify for Listing on the Main Board of The Exchange an Issuer shall meet the Initial Listing Standard set forth in either (a) (b) or (c) below and shall submit an Application, which should be made at the earliest possible date in the form set out in Appendix II.(a) Initial Listing Standard A The Issuer shall: i. Be registered as a public limited company with no restrictions on the transfer of fully paid shares; ii. Have a minimum of three (3) years' operating track record; iii. Have a pre-tax profit from continuing operation of not less than N300million cumulatively for the last three (3) fiscal years and a minimum of N100 million in two (2) of these years;
iv. Have financial statements which shall be compliant with the applicable SEC rules and covering the last three fiscal years provided that the most recent statement at the time of submission of the application is not more than 9 months old;
v. Ensure that a minimum of 20% of the issued share capital is made available to the public and held by not less than 300 shareholders; vi. Have shareholders' equity of not less than N3billion among other requirements. See Rule 1of the Nigerian Stock Exchange Listing requirements (The Green Book) See generally the listing rule for a comprehensive requirement.
[67]Gullifer and Payne(n10) p.407

companies, where an already existing company want to increase its equity base in order to fund business expansions, or introduce new products or reduce borrowings, it can also resort to an IPO.[68]However, it is pertinent to note that not all public companies at the start- up of the business are required to offer their shares to the public if they have enough finances to run their business.[69]This implies that an IPO is not an automatic process for a company. Notwithstanding the arguments in favour of accessing finance through an IPO, in the UK , this process can be costly, time consuming and complex[70] the same can be said of when considering an IPO in Nigeria as the company will have to meet up with the various rules,[71] regulation and laws pertaining to IPOs, which a new enterprise coming up may not be able to meet at the initial start- up stage. This may discourage the new business from embarking on an IPO.

The practice of accessing equity finance through an IPO, can be contrasted with partnerships and private companies that are restricted statutorily from external finance through an IPO as they are unable to sell their shares. What then happens to these forms of enterprises when they need finance? For private companies, this has already been settled by CAMA once they get an authorisation from the court, they will be able to invite the public to subscribe to its shares.[72]While partnerships and LLPs, will rely solely on contributions from partners and loans from banks and the various governmental policies and in so doing, often use personal assets as forms of security to the bank or by borrowing from family and friends with more or less contractual agreement or selling shares held in existing company in order to raise capital.

When a business chooses equity capital in floating an enterprise, it does not have an obligation to make interest payments or to repay shareholders initial investment although it might distribute some of its profits as dividends to shareholders, or skip these payments if necessary.[73] Notwithstanding the aforementioned, equity capital can lead to loss of ownership or dilution of shares on the part of the controlling shareholder, for when a business raises too much equity capital, the controlling shareholder risks losing control of the company because investors are typically entitled to vote on certain company matters. Hence in a situation where a large equity

---

[68]*Ibid* p. 408

[69] Davies P Worthingthon, Gower and Davies, ' *Principles of Modern Company Law'* (9th Edition Sweet and Maxwell 2012) p. 874

[70]Gullifer And Payne (n10) p. 410

[71] Rules such as the Securities and Exchange Commission (SEC) Rules, The Nigerian Listing rules (The green book) of the Nigerian Stock Exchange 2012, the Investments and Securities Act 2014(as amended) among others.

[72] CAMA Section 22

[73]Bryan Keythman, Demand, Media *Advantage and disadvantage of Equity capital* http://smallbusiness.chron.com/advantage-disadvantage-equity-capital-58005.html last accessed on 26/9/ 2016

stake is sold to an investor, or a group of investors, they might try to influence the company in a way with which the former controlling shareholder do not agree. For example, if your business sells like 60 percent stake in the company to an investor, he might take control over the company if he is unsatisfied with your performance.[74]With every share sold to investors, shares owned by former shareholders are diluted, or reduce your ownership stake in your small business and the power of existing shareholders because equity investors typically have the right to vote on important company decisions, you can potentially lose control of your business if you sell too much stock.[75]

3.2 **Debt Financing**

Debt financing refers to financing through loans under which a company, partnership or sole proprietor enters into a debtor/ creditor relationship with the financier/ lender.[76]Financing through loans by new enterprise can be by way of loans or debt securities. However, the type of debt financing used by any company is dependent on a number of factors, the most important being, the size of the company, it appears that debt securities can only be available to very large public or private companies because they are tradeable.[77] This is not favourable to partnerships. Debt securities can take the form of bonds or debentures.[78]Debentures are instruments issued to lenders by a company acknowledging indebtedness.[79]

Another factor to also be considered in debt financing is the cost of finance determinable by outside factors such as interest rate.[80] The promoter will have to consider these measures in making a decision in choice of legal structure.

For a company to be able to borrow money to finance its business, such power must be provided for in the memorandum and articles of association, this is known as borrowing power[81] unless it is prohibited in the memorandum or articles of association. It has been observed that very few companies have sufficient cash from equity capital to meet every obligation. Also, it will not also be good business practice

---

[74]*Ibid*
[75]*Ibid*
[76]Macneil(n1) p. 209
[77]Gullifer and Payne(n10) p.20-21
[78] According to Orojo, p 188'A debenture denotes an instrument issued by the company, normally but not necessarily called on the face of it a debenture and providing for the payment of, or acknowledging the indebtedness in a specified sum…at a fixed date, with interest thereon' Debentures may be registered, perpetual, bearer, convertible or secured naked debentures.
[79]*Ibid*
[80]*Ibid*(n71)
[81] This also is recognised under section 166 of CAMA as the power to create a debenture and debenture stock.

to rely solely on equity finance.[82]Little wonder the most popular source for debt financing is loans from banks, but debt can also be issued by a private company or even a friend or family member because there are no restrictions as to where a business can borrow from.

Companies borrow money to expand their business, to invest in capital expenditure which will result in future income streams and to enable it to meet current expenditure(s) to achieve a future income. To this end, the need for debt finance is a question of cash flow, since it is usually short –term to enable capital circulate, equity financing becomes unsuitable.[83]However, the forms of corporate debt finance and the terms in which it is made available depends on the agreement between the borrower and the lender provided they desist from agreeing to anything that is illegal, conceptually impossible or contrary to public policy, the law will ordinarily give contractual effect to whatever bargain the parties agrees on.[84]An enterprise may secure lending facilities in which it can draw from time to time an agreed overdraft facility which is often familiar or it may borrow a principal amount all at once or in an agreed instalments.[85] Interest will usually be charged on amounts borrowed and the company may also be required to pay guarantee or negotiation fees in respect of the lending facilities.[86]

Debt finance commonly contains covenants or agreements by which the enterprise undertakes to meet performance targets, refraining from certain activities and to always provide the lender with information about its business. This agreement enables the creditor to monitor the company during the subsistence of the loan.[87] For a loan agreement or debt finance to be perfected, it is mostly required that the borrower which is the new enterprise fulfils some conditions such as: supply of the Memorandum and Articles of Association or the Constitution and the resolution to borrow. This is to enable the financier or lender know that the company is not acting *ultravires* or that such was duly authorised.[88]

Considering that one of the forms of debt finance is debt securities, companies structured in partnerships and business name models will face more difficulties in securing debt finance because they are unable to issue and trade debt securities on the public markets unlike public companies therefore, they will resort to use of loans from banks or from family members or from partners. In doing so, they may be required to

[82]Gullifer and Payne(n10) p. 19
[83]*Ibid*
[84]E.Ferran '*Company Law and Corporate Finance*' (Oxford University Press 1999) p. 457
[85]*Ibid*
[86] *Ibid*
[87]Macneil(n1) p. 208.
[88]*Ibid*

grant bank securities over the partnership assets. Furthermore, partnerships cannot grant floating charges unlike companies[89]this may impact the partnerships ability to access debt finance and may opt for the limited liability partnership which is allowed to float a charge.[90]

The three ways in which debt finance operates are: Firstly, it provides a contractually guaranteed return to the lender in the form of interest which may be at a fixed or floating rate. Secondly, lenders are entitled to repayment on a pre-determined rate (maturity of the loan) and thirdly, lenders assume less risk than shareholders as in the event of the company's insolvency, they take priority over shareholders in claiming the remaining assets of the company.[91] Notwithstanding, the enterprise has maintenance of ownership rights, once it has entered an agreement with the lender or bank, it is required under the lender-creditor agreement to pay the agreed sum at the set time agreed. This is the only obligation it has with the lender and thereafter choose to run the business the way it deems fit without the lenders interference, It provides the entrepreneur with some financial freedom and decision making powers , control and also become entitled to all the profits that accrues without any form of hindrances . The debt is limited to the loan refund period. After the repayment period, the lender has no further claim on the business.[92]

Debt financing introduces leverage into the financial returns of shareholders with the result that changes in the financial performance of the company have a greater effect on shareholders than if the company is financed entirely by equity. This is because debt financing carries a fixed cost whereas dividends paid to shareholders are discretionary and are paid only after interest on debt and capital has been paid.[93] Debt capital requires a business to make periodic payments to a lender. These payments might include interest, principal or both. If a company is unable to make these payments, it risks losing assets it pledged as collateral and might be forced into bankruptcy. For example, where a business equipment is used as collateral for a small-business loan, but repayments are not made as at when due, the lender may take the equipment to satisfy the loan or the business may be forced to file bankruptcy to repay its loan.[94]

---

[89] CAMA, section 178

[90] Lagos State Partnership law (2009), section 78

[91]Macneil(n1) p. 209

[92]http://www.bizoffice.com/why-financing-is-important-to-your-business/ last accessed on 26/9/ 2016

[93]Macneil(n1) p. 210

[94] B.Keythman, 'Risk of both debt and equity capital to companies' http://smallbusiness.chron.com/risk-debt-equity-capital-companies-46350.htm last accessed on 26/9/2016)

3.3 Other Factors to be considered in the choice of legal structure

Access to finance has been espoused above as a key factor in deciding on a legal structure to undertake when forming a new business, however, apart from access to finance, there are other factors that need to be considered in choosing a legal structure such as the registration process, rules governing disclosure and accountability.

A partnership structure does not need a board, it is an ownership-manager structure, all partners are agents of the firm, it has less formality and regulation process it does not make its financial returns open to the public and decisions are made quickly. However, partners do not have limited liability and separate legal personality doctrine as it is predominantly guided by the partnership agreement, and thus not shielded in case of the business going insolvent unlike the limited liability companies and the LLPs. The LLP model is relatively new in Nigeria and is operative in Lagos state. The LLP is a hybrid of the general partnership and companies as the partners enjoys limited liability. When it comes to external finance, although it is unable to raise equity finance, it has the opportunity of accessing debt finance and can issue debt securities through floating of charges which the traditional partnership is unable to do. However, it does not face a high level of disclosure regime like the public and private companies. For incorporated companies, a promoter or business owner will have to consider the rules governing disclosure and accountability which are mandatory. They include but are not limited to filing and delivery of annual returns,[95] holding of statutory meetings for public companies,[96] annual general meetings,[97]have accounting records, financial statements[98]preparation of annual accounts by the directors which must comply with the requirements under CAMA 1990[99] and meeting up with all forms of compliances and corporate governance codes required for a publicly traded company. Suffice to state that these forms of disclosure are not present in a partnership model, however under the business name model, the business is statutorily required to deliver annual returns[100]while financial disclosure can also be seen as one of the disadvantages of the LLP as they are also require to file annual returns.[101]

4. Conclusion

The paper considered that access to finance through debt and equity is a key factor that determines how a promoter or business owner choose the legal structure for his business. This factor is key because financing is important for any enterprise to be successful. In Nigeria, access to finance is salient considering the volatile nature of

[95]CAMA ,Section 370,
[96] See generally CAMA, Section 211
[97]*Ibid*, Section 213
[98]*Ibid*, Section 331
[99]*Ibid*, sections 334-335 CAMA
[100]*Ibid*, Section 587
[101]Partnership Law Lagos State, (2009) Section 77

the Nigerian economy as it is and financial markets in general. This paper highlighted the various enterprise models with its advantages and disadvantages. It pointed out that the concept of LLPs is quite new in Nigeria and so far has been adopted by only Lagos State through the 2009 amendment of her partnership law. Thus the paper recommends that other States should also amend their partnership laws to accommodate the LLPs structure which also gives protection and wider access to accessing funds to the business model; this will make the LLP popular and acceptable. The paper posits that if States adopt this form of business model, then there will be more acceptance of this business model than the general partnership model.

The concept of debt and equity finance was discussed focusing on how companies and the various business models can access the financing options. The paper highlighted that partnerships are precluded from equity financing as they do not issue shares or have a share capital, therefore they rely more on debt finance.

Be that as it may, an incorporated company limited by shares has the same means of accessing finance through debt or equity. This paper recommends that neither of the options to access finance be relied on solely by incorporated companies as both options can be utilised simultaneously by a corporation limited by shares to ensure that the company's business is run smoothly.

Enterprises should also ensure that it registers as an SME to enable it access the funds set aside by the various governmental agencies, schemes and incentives. With this, they are likely to be able to access up to 100 million naira with the lending rate under this scheme being at Prime Lending Rate (PLR) of the participating Banks. This is usually cheaper than accessing loan directly from the bank. Therefore, the various governmental agencies should create awareness of the various source of funding new enterprises may benefit from as this may help to lure back some investors who have fled the country and for would be investors and business owners. Lawyers who advise clients on business structures should inform their clients about LLPs as a form of business structure.

In conclusion, it can be said that even though entrepreneurs tend to run or dictate their business but most often than not, businesses are dictated by source of funds and this is what informs the structure of the business, not the original intendment of how their business should be run. Notwithstanding this, the paper reiterates that a business structure is not only informed by access to finance but also by other factors such as limited liability and the various disclosure regimes which are key components to deciding on a legal structure by a promoter or business owner.