

TOPIC CAPITAL MARKETS IN UGANDA

18.1 Introduction:

Any business will require finance to start or expand its activities. This finance cannot be easily accessed through commercial banks where the interest rates are high and the requirement of a security being one of the prerequisite to get the loans. Capital markets provide a solution to this problem especially where long term finances are concerned. These capital markets also offer other investment opportunities.

Capital markets are almost similar to other markets but differ in terms of the products traded and their organisation. Capital markets deal with the trade of financial products such as shares, bonds issued by the governments or private companies, units in collective investment schemes, debentures, etc. These financial products are collectively referred to as securities in Uganda, the market where these securities are traded is called the Uganda Securities Exchange (U.S.E.).

18.2 TYPES / INSTRUMENTS USED IN CAPITAL MARKETS:

One of the ways through which capital is raised in business is through issuing financial instruments. Some of these instruments include:

- a- Bond: This is a certificate issued by a company acknowledging that money has been lent to it and that it will be paid back with an interest at a specified period of time. When you buy bonds, you are lending the bond issuer money in return for a fixed rate of return, they are therefore known as fixed-income investment and therefore become a creditor of the company.
- b- Shares: This is a unit of ownership of a company, When you buy a share, you become a part owner or a shareholder of the company. An investor will buy stake in business by buying shares which will automatically entitle him or her to a company's profits.
- c- Debenture: This is a document showing that a company has borrowed a certain amount of money from a person named on it. The company pays a fixed rate of interest on this loan.

Roles of Capital Markets in Business:

- Raising funds through the sale of shares.
- Provision of a market where the selling and buying of shares takes place in an organised manner.
- Attracting foreign investors who may wish to invest their money in an organised capital market.
- Better standards of living brought about by increased employment opportunities caused by increased investments.

18.3 TYPES OF SHARES:

There are two types of shares i.e. ordinary and preference shares

Ordinary shares are the common ones that are held by the owners of the business and they usually do not have a fixed rate of dividends realised from the business profits.

Preference shares are those where the holders do not have voting rights but have a right to a fixed rate of dividend before any dividend is paid out to the ordinary share holders, they also have the first

priority over the business assets over ordinary share holders in an event of winding up.

Preference shares are further categorised into:

i- **Cumulative preference share** holders of these shares are entitled to a fixed rate of interest every year, irrespective of whether the business has made profits or not, this means that in case the holder misses dividend for a year (may be when the company has incurred losses), he/she will receive a double share in the following year.(the dividends will continue to accumulate until paid).

Non-cumulative preference shares: holders of such shares are entitled to a fixed rate of dividends only when a company has realised profits.

Redeemable preference shares: these shares are bought back (redeemed) by the company after a stated period of time.

Irredeemable preference shares: these are ones that cannot be redeemed / bought back by the company.

Participating preference shares: holders of such shares are entitled to a share of the surplus profits remaining after the ordinary shares have been paid i.e. on addition to their fixed rate of dividends.

18.4 TYPES OF DEBENTURES

Naked debentures: These are debentures which are not secured i.e. no property of the company has been pledged against them. So in case of bankruptcy or winding up, these debenture holders will just be regarded as ordinary creditors of the company.

Mortgaged debentures: These are debentures which are secured i.e. some property of the company has been pledged against them which can be resold in case of winding up to pay off the mortgaged debentures.

Redeemable debentures: these are debentures which are supposed to be bought back by the company any time after the specified minimum period e.g. if the period stated is between 2-4 years, they can be redeemed any time after 2 years but before 4 years elapse.

Irredeemable debentures: these are debentures which are never refunded until when the company is winding up.

18.5 DIFFERENCES BETWEEN A SHARE AND A DEBENTURE

- i- A share is a unit of capital while a debenture is a unit of a loan in a company.
- ii- Share holders earn dividends i.e. part of the company's profits whereas debenture holders earn interest which is an expense that a company has to pay whether it has realised profits or not.
- iii- Shares are usually irredeemable while debentures are usually redeemable.
- iv- At the time of winding up, the debenture holders get only the face value and a specific interest even if the company's assets fetch returns while share holders in most cases enjoy much more than the face value of their shares.
- v- A share holder is a member of the company whereas a debenture holder is a mere creditor to the company.
- vi- In case of decision making in the company, share holders have voting rights whereas

debt holders do not have them.

18.6 CAPITAL MARKETS AUTHORITY (C.M.A.)

Capital Market Authority is a semi-autonomous body that was established by the government (1996) to oversee the operations of capital markets, it is responsible for promoting, developing and regulating the capital market industry in Uganda, with the overall objective of investor protection and market efficiency.

18.61 FUNCTIONS OF CAPITAL MARKET AUTHORITY.

- a- To regulate and promotes the development of capital markets in Uganda with particular emphasis on creation of incentives for longer term investments in productive ventures.
- b- To guarantee and approves the stock exchange operations and security depository systems.
- c- Approving and giving licenses to brokers or dealers in stock exchange and investment advisors like Uganda Securities Exchange.
- d- Approving all offers of securities to the public.
- e- Protection of the interests of investors.
- f- Approve collective investment schemes.
- g- To advise the government on rules and regulations governing operations of capital markets.
- h- To provide protection to investors -both foreign and local.
- i- To create markets in which securities are issued and traded.
- j- To provide facilities for raising long term capital funds.
- k- To act as a yardstick / guidelines to companies' performance.
- l- Providing avenues for those who require additional capital and others who wish to invest their money.
- m- Regulating the operations of a compensation fund.

NB: These can as well work as the Objectives or benefits of Capital Markets Authority.

Capital Markets Authority (CMA) is different from the Uganda Securities Exchange (USE, commonly known as stock exchange) in that CMA is a regulatory body that over sees the

capital market industry in Uganda, while USE is the actual market where capital markets products are traded. The USE is licenced and regulated by the CMA

Currently the Uganda's capital markets industry deals in three products in which one can invest, i.e. shares, collective investment schemes and Government / corporate bonds.

18.71 THE STOCK EXCHANGE

This is a market where the existing stocks and bonds are exchanged smoothly. It is an organised market where traders of securities meet as dealers/brokers represent them and acquire or sell securities. The Uganda Securities Exchange was licensed in 1997 by the capital markets authority of Uganda to operate as an approved Stock exchange.

18.72 PLAYERS IN A STOCK EXCHANGE

These are the different people, group of people or companies that play different roles in a stock exchange.

1 **Brokers:** These are more of middle men or financial professionals who are authorised to buy and sell shares on behalf of the clients or investors, they try to buy at a cheapest price possible and then sell to some one else at a higher price.

2 **Jobbers:** These dealers buy and sell securities in their own names. Their reward is the jobber's

return being the difference between the buying price and the selling price of the shares. Jobbers are further classified into:

a- **Bulls:** are jobbers who buy shares when they are cheap in anticipation that the price of these shares will rise in the near future and he/she will be able to sell them at a higher price.

b- **Bears:** are ones that sell shares when prices are high on his expectation that these prices will fall in the near future when he will be able to buy them again.

c- **Stags:** are ones that buy shares of a newly established company in the hope that prices will rise to be resold. They deal in new issues of a company.

3 **The Registrar:** This is the one in charge of keeping records in respect of stocks and

shares.

4 **Investment Advisors:** these are licenced professionals who research into the financial stand of companies to be taken to the stock exchange, make recommendations on which securities to buy or sell.

5 **Share holders:** these are individuals or groups of individuals or companies who contribute money in a business with an expectation of returns afterwards.

6 **Capital Market Authority:** it is a body established by government to over see the operations of Uganda capital market investment opportunities through capital markets like;

- investment in shares
- investment in bonds
- collective investment schemes (small savers pool resources which are invested collectively in buying shares)

18.73 FUNCTIONS OF STOCK EXCHANGE / U.S.E.

- a- It provides a facility for raising funds for investment in long term assets.
- b- It mobilises individuals' savings so as to carry out investment in productive enterprises, like buying shares in different companies with a view of enjoying benefits there after (dividends and more returns)
- c- It helps new and small businesses to improve access to finance that can be used to expand them, this is done through mobilising and making arrangements to sell their shares for money.
- d- Creation of liquidity, i.e. ability of securities to be changed into cash at a market price. Acquiring and selling of shares is cheap, simple and may be done at any time that suits an investor's convenience.
- e- It leads to the growth of related financial service sector as institutions like insurance companies develop a spirit of savings, USE comes in and provides an avenue through which financial securities can be traded by such institutions in order to facilitate their activities as financial intermediaries.
- f- It facilitates equity financing as opposed to debt financing, equity financing is flexible as the company

pays share holder depending on performance, where as with debt financing, the holder is entitled to a fixed sum of interest disregarding the performance of the company.

- g- It facilitates the divestiture of government owed companies, the privatisation process through capital markets involves the floatation of shares and needs a secondary market for its success, thereby indigenous people are able to attain a stake in the privatised company.

The current equities that are on stock exchange (as at 3rd May 2012) and the period they were listed include:

- i- British American Tobacco Uganda Ltd(October 2000)
- ii- Bank of Baroda (November 2002)
- iii- Dfcu (October 2004)
- iv- Centum Investment Company Limited
- v- East African Breweries (March 2001)
- vi- Housing Finance Bank
- vii- Equity Bank (June 2009)
- viii- Jubilee Insurance (February 2006)
- ix- Kenya Airways (March 2002)
- x- Kenya Commercial Bank Group (2009)
- xi- Nation Media Group
- xii- National Insurance Corporation
- xiii- New Vision Group (Printing and Publising Co. Ltd (Deember 2004)
- xiv- Stanbic Bank Uganda Limited (January 2007)
- xv- Uganda Clay Limited (January 2000)
- v- Jubilee Holdings (February 2006)

18.8 THE PROCESS OF BUYING / SELLING SHARES

- You can buy shares during the Initial Public Offer period or from existing shareholders.
- New issues of shares usually take the form of Initial Public Offering (IPOs), where shares are sold for the first time to the public. This is referred to as the **Primary market**.

- The purchase from existing shareholders takes place in a secondary market where shares are traded on the stock exchange.
- You can sell/buy your shares by contacting a licensed broker/dealer who will help you sell your shares on the stock exchange. CMA issues licenses to qualified firms or persons to transact business on the Exchange or give investment advice. These are known as broker/dealers and investment advisors.

NB: A **primary market** is a market in which a company offers its shares to members of the public for the first time. It is also known as an Initial Public Offering(IPO). To buy shares during the IPO, a share application form (SAF) is obtained from participating broker/dealers and authorised selling agents, which is completed by the prospective investor.

- The SAF is then filled, payment is made and sent to the lead broker where the share allocation is made and a receipt issued to the purchaser.
- If the offer is over-subscribed (application exceeding the number of shares available), the shares

available are divided among applicants according to the allotment criteria and the investor then receives a refund for the shares paid for but not received.

- The successful applicants are then sent their share certificates through the broker/dealer or authorised selling agent.

NB During an IPO, a prospectus / information memorandum is given out

A **prospectus** it is a legal document that gives general information about the company, which is offering its shares to the public like the company's history and operations, products and services. It can be a notice, a circular, an advertisement or any other invitation offering to the public a chance to purchase shares or securities of a company.

An **information Memorandum** is a document containing details about an issuer of debt securities such as corporate bonds. It contains information about the company, amount issued, purpose of the issue, whether it's guaranteed or not, repayment terms, etc.

A **secondary market** is a market in which the securities (shares or bonds) are traded on the stock exchange. Here, securities can only be bought / sold through a licensed broker/dealer, that is a firm that buys and sells securities on behalf of investors for a commission or a brokerage fee.

NB: Before investing in shares, you should be clear about your own financial position and what you hope to achieve from your investment. To sell shares, you need to contact a broker/dealer and instruct him/her to sell either all or some of your shares. Secondary market trading takes place at the Uganda Securities Exchange (USE) on Mondays, Tuesdays and Thursdays from 10.00am to 12.00pm.

If the value/price of shares falls, you cannot be compensated, like any other investment, investing in securities carries a risk. The price of the shares can fluctuate and if you choose to sell your shares at a particular time, then you could either make a loss or a gain.

18.91 BENEFITS ENJOYED BY A SHARE HOLDER

- a- Dividends; when a company makes profits, the Board of Directors may give a percentage of the profit to its shareholders which increases the income of the investor. The unshared profits that remain in the company as capital are termed as **Retained Earnings**.
- b- Capital gains; when shares are sold at a price that is higher than the price at which they were purchased, this represents a profit which is termed as **capital gain**.
- c- Shares may act as a collateral security for the owner, for instance if he wishes to access a loan from financial institutions.
- d- Ease of transferability; shares can be passed on from one person to another, for instance they can be inherited.
- e- Capital growth; when the company grows, the value of the shares will also grow, hence benefiting the share holder

18.92 DISADVANTAGES OF INVESTING IN SHARES:

- a- Share prices can go down or up depending on a number of factors such as the performance of the company, the economic situation, demand and supply factors, etc
- b- If the company's profits fall, the dividends will fall and if the company makes a loss, it may not pay any dividend at all.
- c- If the share prices fall, their value lessens.

- d- If the company collapses or becomes insolvent, the shares become worthless.
- e- If the company goes into liquidation, shareholders are the last to be paid after all other creditors.

In summary, the process of buying and selling shares involves the following:

The process of buying shares

- Place an order through a broker / dealer
- Fill client's information form after reading through the company prospectus.
- Sign a purchase transfer
- Pay for the number of shares you are willing and able to buy.
- Receive a receipt from the broker/dealer

On the day of executing the exchange;

- The broker sends to the buyer a purchase contract note/document (legal) which entitles or acts as a proof of ownership until the certificate is received.
- Dealers / broker forwards the signed purchase transfer to the Registrar through the exchange.
- The Registrar upon receiving transfers issues a certificate (a legal document confirming ownership of shares).

The process of selling shares:

- Find out how much shares are selling in the market i.e.through the broker or newspapers or even through the stock exchange.
- Contact the dealer/broker and place an order to sell shares at a price that is satisfactory to you.
- After placing an order, the broker sends a sales contract note that shows the net proceeds payable.
- Collect the check from the dealer / broker.

NB: If the offer is over subscribed (applicants exceeding the number of shares available), the shares available are divided among applicants according to the allotment criteria and the investor then receives the refund.

When Buying through a secondary market:

- Place an order through a broker
- Fill a clients information form
- Sign a purchase transfer
- Pay for the number of shares one is willing to buy
- Receive a receipt from the broker / dealer.
- Then on the day of executing the exchange, the dealer / broker sends to the buyer a purchase contract note (legal document / proof of ownership until the certificate arrives.
- Dealer / broker forwards the signed purchase transfer to the registrar through the exchange
- The registrar upon receiving transfer issues a certificate (a legal document confirming owner ship of shares)

INVESTING IN BONDS

A bond is essentially a loan an investor makes to the issuer of a bond. The investor receives regular interest payments on this loan until the bond matures or is called, at which point the issuer pays you the principal. Certain bonds have special provisions.

Bonds are issued by Government entities and corporations to raise money for their endeavors. There are four major types of bonds representing the four major issuers.

* **Government (Treasury):**

Government issue treasury bonds to pay for government activities like paying off the national debt or fighting inflation. The yield is lowest among bonds but considered low in risk if held until maturity. Bonds are exempt from state and local taxes.

* **Municipal :**

States, cities, counties and towns issue bonds to pay for public projects (like roads)and finance other activities. They are also exempt from taxes (majority of them).

* **Corporate :**

Corporations issue bonds to expand, modernize, cover expenses and finance other activities.

The yield and risks are generally higher than governmental and municipals. They are fully taxable.

*** Mortgage-backed :**

Banks and other lending institutions pool mortgages and offer them as securities to investors. These bonds have a yield that exceeds those of corporate, with comparable maturity. They are also fully taxable.

HOW BONDS WORK?

Bonds have three major components. i.e.

a- The face value (par value). This is the value of the bond as given on the certificate or instrument. It is the value the bond holder will receive at maturity unless the issuer defaults. If bonds are retired before maturity, bond holders may receive a slight premium over face value.

b- Coupon rate : This is the annual rate of interest payable on the bond. For the owner of the bond, the higher the coupon rate, the higher the rate of interest payment the owner receives. The rate is set at the time the bond is issued and generally does not change.

c- Maturity :

This is the date upon which the issuer pays back the face value of the bond. The bond terminates at maturity.

Example :

A company issues a Shs 1,000,000 10-year bond with a 5% coupon rate. Each year, the owner receives 50,000 shillings (5% of 1,000,000), paid in two semi-annual installments of Shs 25,000.

18.2 ADVANTAGES OF INVESTING IN BONDS

- i- Bonds are predictable. You know how much interest you can expect to receive, how often you will receive it, and when your principal (the bond's face value) will be repaid (maturity date)
- ii- Bonds are steadier than other stocks which fluctuate wildly in short term, that's

- why most investors prefer buying bonds than equity investments which are more volatile.
- iii- People on a fixed income and / or in retirement will receive a predictable amount of regular income from bonds since most bonds pay interest to holders on a regular basis apart from the zero coupon bonds.
 - iv- The interest rate paid by bonds typically exceed those paid by banks on savings accounts, especially short term bonds.

18.2 DISADVANTAGES OF INVESTING IN BONDS

- i- Companies and municipalities can and do go bankrupt and in case they do, your bonds will lose value and possibly even become worthless.
- ii- Long term bonds will have your money tied up in low yielding bonds if interest rates go up.
- iii- Unlike stocks, bonds do not offer the possibility of high long term returns. Younger investors and those with several years to go until retirement would be better served by limiting their bond purchases and opting for equity buys instead.
- iv- Although they are less volatile than stocks, they are not immune to price fluctuations. Bonds from riskier companies can be very volatile, it is also possible for a company to default on bonds issued, resulting into a total loss of principal for the bond holder.

18.3 INVESTING IN COLLECTIVE INVESTMENT SCHEMES

There are many ways of savings and investments in business, one of them is through capital markets and specifically through Collective Investment schemes.

Collective Investment schemes are private financial arrangements that provide a means for mobilisation of savings and enable small investors to participate in capital markets. They pool resources of many small savers, generating a large pool of funds, which resources are then invested in various assets like shares, bonds, property and treasury bills with the sole purpose of generating high returns while minimising risk through

diversification of investments.

The CIS Manager invests all the money received from the different small savers, when the investments make returns afterwards in terms of capital gains and dividends, the manager distributes these returns amongst all the investors. So everyone gets a share of the profits according to the money invested.

A CIS Manager is a person licensed by the Capital Markets Authority to undertake, on behalf of the client the management of CISs.

Ordinary people are the main participants in these schemes although they may also attract institutional investors such as pension funds or insurance companies.

CIS are governed by the CIS Act 2003, which sets out the duties and obligations of the various parties that are involved in the formation of a scheme. One of the parties is a Custodian whose duty is to safeguard the funds of the investors while the CIS Manager only makes investment decisions.

There are two types of schemes in Uganda i.e. Unit Trusts and Investment Company with Variable capital.

a) **A Unit Trust Scheme** is an arrangement where by investor's funds are collected together and later used to invest in securities and other financial assets with the beneficial interest in the assets of the trust divided into units. In this scheme, the investors buy units, which represent the units they hold in the scheme.

The unit trust scheme is established by a trust deed between a fund manager (which must be a body corporate) and a trustee (bank or insurance company)

The trust deed spells out the duties and obligations of the fund manager and trustee. In a unit trust, investments are made on behalf of the unit holders by the unit trust manager but the assets of the scheme are held by the trustee or custodian. The manager purchases the investor's unit at the ruling price and the investor's money is deposited onto his/her bank account within two days.

The trustee is important for the following reasons:

- Overseeing the fraud
- Safeguarding the assets of the scheme
- Ensuring that the fund manager manages the fund according to the trust deed
- Ensuring tha the fund manager manages the fund according to the trust deed.

b) **Investment Company with variable Capital (ICVC)**; this is a type of scheme where one's investment is represented by the shares they hold. The scheme takes the form of an ordinary company, however, the key factor that distinguishes it from an ordinary company is that the company is allowed to buy back the shares when an investor wishes to pull out.

The main difference between the two is the form they take, one is organised as a trust and the other is a company but both forms of CISs involve the pooling of investors' contributions, which are invested on their behalf.

However, an investor should note that in both types, investors are not involved in the day to day decisions concerning how their money is invested. The investors pay a commission not exceeding 2% to the fund manager as a fee for managing their investments. The scheme therefore makes money by managing other people's money. Investment income and capital gains generated by the scheme are passed on to the investors and are shared in proportion to the investors' holding in the CIS

18.4 ADVANTAGES OF COLLECTIVE INVESTMENT SCHEMES:

- a) It encourages diversification of risks:- investors csn secure a much wider diversification of risk, because these funds are invested in different securities. Studies show that the greater the diversifiatioin of a portfolio, the lower the risk in relation to the return. Those who invest in CISs are therefore seeking to lower risk in relation to their returns.
- b) It eases accessibility to securities investments:- By investing a small sum (either in a lump sum or on a regular saving basis), an investor through the CIS can achieve a personal portfolio spread over several securities. Investors can access high

priced markets because of the pooled resources which create a larger fund.

- c) It lowers transactions costs:- By investing in CIS, investors incur lower costs than if they were to buy and sell shares /bonds directly. This is because transaction costs are generally related to the size of the transaction, and investors benefit from the fund manager's ability to deal in larger quantities of shares at lower average dealing costs. Fund managers can also reallocate portfolios more efficiently than individual investors.
- d) It facilitates professional management:- Due to the complexity of analysing information regarding individual securities, most individuals do not have the professional skills to manage their own investments. CIS provide full time professional management in a direct and simple form and this is especially important where market information is not widely available.
- e) It creates investor protection:- CISs have succeeded in developed markets due to an effective legal and regulatory framework. People need to have confidence that their money is protected from fraud, theft and other forms of abuses.
- f) Liquidity is made easy:- It gives an opportunity to easily liquidate investments by selling your units back to the Unit trust manager. The manager is obliged to buy the units.
- g) There is easy performance monitoring, the net assets value per share or the bid and offer price the investors of open ended funds are reported in the press, internet sites allowing the investor to continually monitor the performance of his/her investment.
- h) Some funds allow investors to buy more shares in a regular basis even with smaller monthly installments.

18.4 DISADVANTAGES OF COLLECTIVE INVESTMENT SCHEMES

- i- Loss of control – when you invest in CIS, you are not directly involved in deciding how your money is invested. As long as the Unit fund managers invest your money in accordance to the prospectus and deed of the scheme, there is little that you, the unit holder, can do if you happen to disagree with their investment decisions.
- ii- Fees and charges : The funds provided by the fund managers are not free. There are fees and

charges payable by the unit holders to the CIS.

- iii- Opportunity cost : i.e. by putting your money in CIS, you lost the opportunity to use it else where and there is no guarantee that putting it in CIS, things will be perfect, thus, in such a situation, you end up losing the money that you would have used productively some where else.

NB: - Portfolios refer to funds managed on behalf of the clients at the discretion of a fund manager

- A Trustee refers to an individual or company that hold the assets of a collective investment fund on behalf of its clients or investors who are the beneficiaries of the trust.

- A unit trust is an investment scheme that pools savings of the public who share the same financial interests, which savings are then invested in securities like bonds, shares, etc.

- A fund manager is a person / company licensed by the Authority to undertake, on behalf of the client the management of a portfolio of funds.

- A trust deed is an agreement between the fund manager and a Trustee or any other authorised corporate Director (ACD)

CONDITIONS NECESSARY FOR THE OPERATIONS OF CIS

- A conducive operation environment
- Availability and conducive banking environment
- Savings environment.
- Maximum cooperation among the savers
- etc

RAISING LONG TERM FINANCE THROUGH CAPITAL MARKETS.

When sourcing for long term finance in business, there are many questions that may arise,

these may include:

- i- Should you apply for a bank loan? But the repayment period is quite short.
- ii- How about the micro finance institutions? The interest rates are quite too high.
- iii- So how about capital markets?

ADVANTAGES OF RAISING LONG TERM FINANCE THROUGH CAPITAL MARKETS

- a- Raising funds: through the sale of shares on the capital markets, businesses are enabled to raise funds, which is cheaper, easier and faster compared to other forms like commercial banks.
- b- Provision of markets to sell and buy shares: Capital markets provide members of the public or other interested individuals or company to buy shares. This provides them an alternative method of investing their savings.
- c- Inflow of international capital: Foreign investors who may wish to invest in the country will find it easier to do so through the capital market where they will buy shares easily, this leads to inflow of international capital which contributes to the growth of the country's economy.
- d- Better standards of living : Increased investment by companies due to the existence of a well organized capital market will lead to more employment opportunities being created, more incomes generated and this may result in more disposable income that people may use for consumption and even more savings.

AVENUES OF RAISING LONG TERM FINANCING THROUGH CAPITAL MARKETS.

There are two avenues through which a business can raise finance in the capital markets i.e. equity financing and debt financing

18.6 EQUITY FINANCING

With this type of financing, the business raises finance by issuing shares to the general public. Those

who buy the shares of the company then become part owners of the company and thus

called share

holders. A company must first apply and seek approval from the CMA before it offers shares to the public.

18.7 ADVANTAGES OF EQUITY FINANCING FOR A BUSINESS.

- a- If your company closes, shareholders' equity contributions will not be paid back until all the company's creditors have been paid.
- b- Your business assets do not have to be pledged as collateral in order to obtain equity investments / sell shares to the public.
- c- The business / company does not have to make debt and interest payments to shareholders.
- d- The company is better governed given the International standards accounting followed by listed companies. Listed companies are those that have officially been accepted to offer shares to the public and therefore are trading their shares on the market.

18.7 DISADVANTAGES OF EQUITY FINANCING

- a- The company owners may have to relinquish ownership of all proceeds and may have to share their business profits with other equity investors / share holders.
- b- Owners will have to be accountable to all share holders and therefore will be required to publish their annual accounts, organize annual general meetings for all share holders and communicate all major assurances in the company to all share holders.

18.8 DEBT FINANCING

A business can also raise finance by borrowing from the public and institutions, through capital markets. The examples of debt instruments include:

- i- Corporate bonds which is an arrangement that enables a company to borrow money from the

- public for a long period of time.
- ii- Government bonds / municipal bonds, which is an arrangement that enables both government and local councils to borrow funds from the public for a long period of time.
- iii- Commercial paper, which is an arrangement that enables a company to borrow money for a short period of time.

18.8 ADVANTAGES OF DEBT FINANCING

- a- The company does not have to give up any ownership of the company.
- b- The lender has no control over how to run the company whose bonds she/he has purchased, all that the lender requires of the company is that the loan and interest should be paid back.
- c- The company is not required to pay the lender dividends when it makes a profit, as is the case with the share holders.

18.8 DISADVANTAGES OF DEBT FINANCING

- a- The company is required to pay back the principle and interest regardless of its financial position.
- b- The company must have sufficient cash flow to repay the loan and interest.

18.9 OTHER SOURCES OF LONG TERM FINANCE FOR BUSINESSES SIN UGANDA

Apart from capital markets, there are a number of other sources of finance for a business, these include the following.

- i- Joint venture; Find an individual or an organization to both invest and work with a company

- in its business project.
- ii- Banks for working capital; short term finance or the working capital necessary to fund the day-to-day running of the business. This can take the form an agreed overdraft, where interest will be calculated on your daily outstanding balance and charged on a monthly or quarterly basis.
 - iii- Banks for medium term loans; a loan paid back over an agreed term – typically 3-10 years, where principle and interest are paid off monthly. This type of loan is used mainly to invest in equipment, expansion and development.
 - iv- Banks for long term loans; this type of loan is normally used to purchase assets like land, buildings, plant or machinery that can be shown to directly or indirectly add profit over a number of years.
 - v- Leasing; this provides finance for the acquisition of specific assets, like cars, equipment, machinery, etc. It involves a deposit and repayments over, typically, 3-10 years. The financier purchases the equipment you need and then leases it to you in return for regular payments for the duration of the lease period.
 - vi- Personal loans; if it is impossible to obtain a loan in your business' name, you could consider obtaining a personal loan. However, check that the conditions do not jeopardize control of the business and that you are very confident of being able to repay or you may lose assets put up as collateral.

- vii- Family and friends; you can borrow money from friends and family, however to avoid any misunderstandings and / or resolve any dispute if things go wrong, it is imperative to make a written agreement, including the loan time period and interest payments.

DISADVANTAGES OF SUCH AVENUES OF RAISING FUNDS

- a- Joint ventures can often result into loss of control over aspects such as policy and development.
- b- Banks have the power to place a business into administration or bankruptcy if it defaults on debt interest or repayments.
- c- Borrowing from family and friends can lead to disputes or interference in the management of the venture.
- d- When seeking financing, consider what source and type of finance suits your needs. Then match the method of funding and the loan to the loan to the reason for the finance. Do not forget that your financing decisions may have an impact on business cash flow and other obligations such as taxation.

END