CONTRACTORS' ACCESS TO FUNDING FOR INFRASTRUCTURE PROJECTS IN NIGERIA: Overcoming the present challenge.

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Abstract

In certain countries, specialized banks are established to fund infrastructure development. These banks provide financing to facilitate the delivery of projects which usually are beyond the financial capability of contracting organizations. Literature confirms that for real development in certain critical sectors of a nation's economy to occur, the support from government and institutional investors are essential.
Hence, the need to evaluate contracting firms' access to capital funds to executed construction contracts.

The methodology adopted is an exploratory qualitative research approach. The study entails interview of 32 contracting organizations top management staff and a director from one the foremost pension fund administrators in Nigeria. The findings show that there are few of such specialized banks or funding organizations for infrastructure delivery in the country. The Central Bank of Nigeria in 2010 provided financing line of N300Billion for Power and Aviation projects alone. While commercial banks are willing to assist with short-term loans, the interest rates and service charges make the contract unprofitable on the long run. This is because most public construction projects are rarely delivered to time. This situation makes the commercial bank loan less desirable. Also, findings show that there are some Development Finance Institutions in the country, but these are hardly able to provide the mega funds required for major infrastructure projects such as roads, dams and rail construction. These have left the operating space for infrastructure delivery to multinational construction firms and highly capitalized local construction companies. Alternative funding sources were proposed for contractors that will be inclusive. That which will be a composite arrangement of capital funds from internal financial institutions, external financial institutions, institutional investors and donor agencies.

Keywords: Infrastructure, Funding, Loan, Contractors, Project Delivery.

1. Introduction

The need for infrastructure development in emerging economies of the world cannot be overemphasized. Infrastructure deficit is huge compared to the growing population of these countries (Oyeranti, Babatunde, and Ogunkola, 2011). Inderst and Stewart (2014) argue that notwithstanding current circumstances, infrastructure development plays a key role in economic growth and poverty reduction. Price Waterhouse Coopers (2014) explains that infrastructure projects are delivered through contractual agreements between governments or funding organizations and construction companies that undertake to provide the needed facilities. Construction projects do not usually require a significant capital expenditure outlay but substantial working capital which is a challenge for most emerging contractors (Construction Industry Development Board, 2011). Du Pleissis (2007) argues that one of the essential requirements for sustainable development is the empowerment of local contractors to participate in infrastructure provision for developing nations to grow. Earlier studies by Anosike, (2004); Kehinde and Mosaku, (2006); Chukwudi and Tobechukwu, (2014) on the subject of financing for contractors in the Nigeria construction industry provide good precedence for this research. However, there is a paucity of research on alternative sources of funding for the emerging contractors. Hence, the gap which this study seeks to fill. Thus, stimulating discussion in the sourcing capital market and institutional investor funds for meeting the needs of emerging contracting organizations for infrastructure projects in Nigeria.

Aims:

To identify the barriers to accessing funds for infrastructure in Nigeria with particular emphasis on emerging contractors.
To explore the available funding opportunities both in the local and foreign markets. To identify funding alternatives for contractors in the Nigerian Construction Industry.

2. Contextualizing the Financing for Infrastructure

2.1 Funding for Construction Industry and Infrastructure Development

Infrastructure development's impact on economic growth is significant. The World Economic Forum estimated that for every 1 dollar spent on capital projects (utilities, energy, transport, and waste management), there is a corresponding 5%-25% economic return per annum. Infrastructure spending for Africa is expected to reach US $180Billion per annum by 2025. The largest investments will be in electricity production and distribution considering investments plans in Ethiopia, Ghana, Kenya, Mozambique, Nigeria, South Africa and Tanzania (Construction Industry Development Board, 2011).

Historically, the public sector has been central to the ownership, financing and delivery of infrastructure projects. Government funding of infrastructure in developing economies like Nigeria accounts for about 70% of total project expenditure. About 20% is financed by Private sources while the remaining 10% is backed by multilateral and bilateral development agencies (Bhattacharya, Romania and Stern, 2012; Delmon, and Delmon, 2011). However, traditional sources of financing are at the limits. Most governments in Africa are hardly able to finance capital projects due to the impact of the global financial crisis of the recent past. Likewise, the resources available to the donor agencies and multilateral funds are unlikely to increase (Inderst and Stewart, 2014). This scenario makes sourcing funds from alternative sources within the private sector needful. Thus, alternative sources of the fund from sovereign funds and pension funds have become more needed now than before.

Recently, China has become a major funding source for infrastructure in Africa. Based on "Infrastructure for Oil" trade agreements, China has made significant strides with Angola. During his last visit to Africa, President Xi reconfirmed China's commitment to providing another $20Billion in infrastructure financing to Africa (Sun, 2013). Empirical data also showed that China's investment in Nigeria grew from $3Billion in 2003 to $6Billion in 2007 with 75% in the oil and gas sector. Gains are already are recorded in Railway and Road Construction Projects in Nigeria (Oyeranti, et al., 2011). The total foreign direct investment in Nigeria grew from $190Million in 1999 to $7.26Billion in 2004 and decreased to $726Million by first quarter 2015 (Oyeranti, et al., 2011; Trading Economics (2015). These showed an increase in foreign interests in African nation's economy.

The African Development Bank and the European Union launched the Infrastructure Investment Programme for South Africa (IIPSA). Thus, raising ZAR 1.5Billion financing for organizations undertaking projects in South Africa and Southern African Development Countries since 2014 (Inderst and Stewart, 2014). Domestic investors or local sources of funds for infrastructure development include: Pension Funds, Insurance Companies and Sovereign Wealth Funds. However, current investment volumes by these entities are still small.

2.2 Sources of Funding for Infrastructure in Nigeria

The sources of funds from credit financial institutions have been majorly through the Money Markets, Capital Markets, Joint Venture Financing, and Institutional Investors (Anosike, 2004). The various forms of funding are shown in Table 2.1

Table 2.1 Forms of funding to Contractors by Financial Institutions in Nigeria

Source	**Term**	**Duration (years)**	**Type of Financing**	**Purpose**
Commercial Banks	Short	0-1	Local Purchase Orders (LPO) Factoring Treasury bills	Working Capital
Commercial Banks	Medium	2- 10	Leases Higher Purchase	Plant and equipment
Capital Markets, Institutional Investor	Long	Above 10	Shares Stocks Bonds	Collateral Capitalization

Source: Anosike (2004)

The Stock Exchange according to Okereke-Onyiuke (1999) is a veritable means of raising long-term funds for development projects. Traditionally, for a company such has emerging contracting organizations to access funds from the capital market is almost impossible due to the regulations and the requirements for listing. However, the capital market operators through the Nigerian Stock Exchange have established a specialized board to accommodate fast growing small and medium scale companies seeking to access the capital market by mitigating the challenges faced by emerging businesses in Nigeria. Emerging Contracting Organizations fall within this group. The Alternative Securities Market (ASeM) have attenuated the requirements for participation by interested companies with adequate support structures (The Nigerian Stock Exchange, 2015).

Likewise, the recent deployment of the gains of Pension Fund Reforms in the country has provided influential institutional investors in funds administrators. However, the use of pension funds is strictly regulated by law regarding where to invest and how much to spend. The Pension Funds Administrators are risk averse and consider construction industry a high-risk sector. Though, funding of infrastructure is done indirectly through Federal and State Government Bonds and in Equities of listed companies on the Capital Market.

The only evidence of direct funding by the Central Bank of Nigeria (CBN) in infrastructure financing is the Power, and Aviation Intervention Fund of 30Billion Naira disbursed through the Bank of Industry for the stated purpose (Central Bank of Nigeria, 2015). Even though, the CBN claims to have reviewed its Prudential Guideline to favor long-term financing needs of Small and Medium Scale Enterprises, Infrastructure and Agriculture. There exist no particular bank established for funding infrastructure construction such roads, bridges, dams, railways, pipelines and waste treatment systems. The Infrastructure Bank as currently structured is just an imitation of what should be if sufficient progress in this regard would be seen.

2.2 The Nigerian Construction Industry

The story of the Construction Industry in Nigeria is that which start with the advent of the oil boom and post- civil war construction in the country led to ill-prepared entrepreneurs regarding management and technological skills venturing into the industry but for the complementary role played by foreign multinational companies (Chukwudi and Tobechukwu, 2014). The Construction Industry in Nigeria has two broad categories of players. The Multinational Companies (some of which are state-owned e.g. China Civil Engineering Construction Corporation (CCECC), etc. and firms that have their parent companies abroad (Julius Berger Plc., Cappa and D'Alberto Plc., G. Cappa Plc.(Nigeria), Reynolds Construction Company, Costain West Africa Plc.) The Indigenous Construction Companies hereafter referred to as Local Contractors. The Local Contractors are composed of two categories; The Large Local Contractors (LLC) -companies with huge capital base and equipment (e.g. Dantata and Sawoe Construction Company Nigeria, and the Small Local Contractors (SLC) – emerging construction companies. Most of the foreign-owned construction companies are listed on the capital market as publicly quoted companies. The emerging construction companies have not had a fair share of the construction market in the country when compared to foreign-owned construction companies that are deemed to be more technically and managerially proficient in fund acquisition and project execution (Oseni, 2002; Akintunde, 2003).

2.3 Challenges of Contractors Access to Funding in Nigeria

In a survey by Price Waterhouse Coopers (2014), access to funding emerged top on the list of challenges to delivering broad and complex infrastructure projects in Africa. The research identified factors influencing access to finance for infrastructure projects as; inadequate regulatory framework, internal capacity limitations, political instability, policy incoherence, reported corruption, and the crippling shortage of skills and capacity. Even though more than half of the respondents still plan to invest more on infrastructure such as new projects and maintain old ones.

Previous studies by Wright (1976) and Cannon and Hillebrandt (1989) posit that the primary reason for high failure rate and low performance by contracting firms in the construction industry is the low level of investment in fixed assets. These assets serve as collateral for loans and tangible asset by the companies. Assets by construction companies could be categorized as either fixed or current assets. Current Assets are cash or marketable securities, work in progress, account receivables and inventory that can be converted to cash within a year. While Fixed Assets are buildings, plants, and equipment that are not expected to be converted to cash within a year or are required for repeated production process (Wright, 1976; Weston, and Copeland, 1989).

Research has shown that contractors in all categories of the construction industry in Nigeria are aware of the availability of funding from financial institutions for funding their projects (Anosike, 2004). However, many are not aware of the types of the funding and how they apply to their operations. Thus, many are reluctant to approach the financial institutions for funds because of anticipated challenges such as; administrative bureaucracies, high-interest rates, stringent conditions and restrictions in the way they run their businesses upon the receipt of such credit facilities. Therefore, many resort to unsecured short-term facilities such as personal loans and overdrafts which require less documentation and collaterals but usually with higher interest rates. This source has become less desirable.

Most emerging contractors hardly plough back their profits to grow their businesses by acquiring plant and equipment. These hardly retain their staff (professional and casual). It is a usual practice to employ staff on a project by project basis (Anosike, 2004). These factors have affected their organizational learning and innovation potentials. Likewise, emerging contractors rarely keep separate accounts from company accounts, undertake audits and have adequate financial reportage. Most board members are relatives and family members. Thus, affecting their rating with financial institutions regarding corporate governance (Anosike, 2004)

Some authors have suggested the establishment of National Construction Bank where emerging contractors can easily access loans after due diligence and ascertaining the applicant’s capability and claims. The authors further suggested the strengthening of the National Construction Policy so that emerging contractors will become technologically empowered (Kehinde and Mosaku, 2006; Chukwudi and Tobechukwu, 2014).

2.4 Lessons from the South African Experience

More than 1400 contracting enterprises were liquidated between 2007 and 2009 in South Africa. The primary reason was the lack of profitability in contracting (CIDB, 2011).This ugly trend made key industry stakeholders: Government, CIDB, Department of Public Works, Banks, Insurance companies to come together to develop some financing model suited to the emerging contractors in South Africa. However, there is limited evidence in literature to show the effect of funding or liquidation of emerging construction companies in Nigeria. The Authorities in South Africa are well aware that without such concerted effort by major stakeholders to help the middle-level construction companies, they will never be able to compete in the construction market with the more established companies in the delivery of required infrastructure. The following funding models were developed:

- **Short Term Financing:** Option A: The Khula Model; Option B: Bank- in – House Contracting Agency; Option C: Use of Entity, and Option D: Project Finance Model.
- **Mid-Term Financing**: Bank in House Contracting Agency and Enterprise Development. This type is a hybrid of the short-term model as it combines enterprise development and internal risk management.
- **Long Term:** Contracting Agency. The Contracting Agency was proposed to be an arm of Government and Private sector. Hence, it was suggested that a Joint Venture Agreement or Public

Private Partnership should drive the initiative. The Contracting Agency would care for the development and mentoring of the emerging contractors. They will be responsible for facilitating guarantees required by clients and evaluating the viability of projects for the emerging contractors. They will also provide entrepreneurial support and monitor disbursement of funds to the contractor (CIDB, 2011).

3. Research Methodology

This research employs an exploratory qualitative approach. Mason (2002) succinctly describes qualitative research as that with the interpretivist philosophical approach. Its data generation processes are flexible and sensitive to the social context in which the data is produced. 32 senior management staff of contracting organizations were interviewed in 3 major Nigeria cities of Abuja, Lagos and Port-Harcourt. A Company Director at one of the foremost Pension Fund Administrators in the country was also interviewed. The purposive sampling method was used to select the respondents. The choice of purposive sampling is due to non-availability of an authoritative sampling frame of construction companies register in Nigeria and the ability to target persons who are best able to respond to the issues of the research (Achuenu, Izam & Bustani, 2000; Muazu & Bustani, 2004).The interviewees have been previously contacted via telephone to seek their consent. Their participation was purely voluntary. The interviews were transcribed and analyzed.

4. Findings and Discussion

The respondents belong to companies that have operated in the Nigerian Construction Industry for 10-25years. All the respondents admit that sourcing funds for the execution of infrastructure projects in the country have been challenging. However, there is uniqueness in the experiences of the interviewees. These shall be discussed according to the categorization of the companies.

Category A
The contractors in this category have access to raise funds in the capital market. Some of the companies were initially solely owned by foreign interests. However, several are currently listed on the Nigerian Stock Market with their shares trading daily (The Nigerian Stock Exchange, 2015). This is made possible because they have met the conditions for listing on the main board due to the enshrined corporate governance culture, functioning and properly constituted boards, adequate financial reporting and capacity to undertake complex and mega projects. However, they still find it challenging to have investments from institutional investors. This is because regulation determines the range of portfolio allowable for Pension Funds Investors to divest in. For instance the current law governing pension fund investment stipulates;

“25% maximum in equities, 35% maximum in commercial institutions and 40-80% maximum in government bonds, 5% maximum in infrastructure and 5% maximum in offshore investments”.

Despite the regulation above, investors prefer to invest in interests with least risk potential. Investors are usually more interested in fully operational projects rather than green-field projects because of the level of risks it entails. This position is supported by Inderst and Stewart (2014). Construction projects are Greenfield projects. Some of the contractors in this category have access to foreign direct investments from or through their parent companies.

Category B
The contractors in the second group have weak corporate governance in their companies. They hardly have access to the capital market and are usually at the mercy of commercial banks. These struggle to have appropriate documentation to sail through application process for loans. They are often disenfranchised due to lack of security or collateral to support loan applications. Personal assets are often the securities presented in the instances where applications for loans gets granted. Construction equipment are very capital intensive to procure, so these companies rely on leasing of major equipment. This position aligns with the argument by Kehinde and Mosaku (2006). However, the contractors in this category should seek capitalization through the ASeM. They should establish proper management functions, engage qualified professionals and acquire fixed assets. Thus, they can grow their companies. This is the trust of the Nigerian Stock Exchange Alternative Securities Market (Mohammed and Aiyeleye (2014). Emerging contractors should constitute proper management boards and institute appropriate corporate governance regarding financial reporting and organization.

Some of the respondents propose the establishment of a specialized bank (National Infrastructure Bank) that will see to the needs and growth of the Construction Industry such as Bank of Industry, Export-Import Bank, and Bank of Agriculture. Interest rates should be worked to fit the peculiarity of the construction industry. Literature shows that there is currently existing a company with the name Bank of Infrastructure in Nigeria. However, this is rarely what the National Construction Bank should be according to proponents. The international funding models in literature are the line of credit, contract financing and project financing. However, there is the need for the homegrown solutions to infrastructure funding that takes into consideration the existing realities of the Nigerian Construction Industry such as the case of South Africa.

5. Conclusion

Construction project delivery is a capital intensive endeavor. Funding from governments has dwindled over the years leading to delayed payments and stalling of projects. The study establishes that the market share by emerging contractors in the Nigerian Construction Industry is small. Thereby presenting evidence that access to funding for emerging contracting organizations has been weak, and they lack the capacity to deliver on large scale infrastructure projects. For there to be a change in this trend, concerted, all stakeholder approach has to be adopted such as establishing a specialized financial institution or/and developing models like in the case of South Africa. However, there are novel initiatives by the capital market and pension funds administrators towards this challenge. There still exist funding from multilateral organization and development partners, but such funds have progressively diminished due to competing demands. Finally, Provision of Infrastructure on the African continent needs not just be purely a business decision but a developmental decision.

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