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Proposal on Financing Options for Ajaokuta Steel Company Limited

Ola Falade, PhD
Augustine, Osigwe, PhD
Olumuyiwa, Yinusa, PhD
Chukwuemeka Onyimadu

Executive Summary

This brief presents various financing options and their implication for the revitalization of Ajaokuta Steel Company Limited. Basically, some of the viable financing options espoused in this brief include: government financing option, international development financial institutions funding, funding from the capital market, Excess Crude Account (ECA), floating of bonds, sales of government assets, and a combination of these options.

I. Brief Introduction

The Federal Government of Nigeria established the Nigerian Steel Development Authority (NSDA) in 1971 through Decree No. 19 in order to advance the development of the Nigerian Steel Industry. Sequel to the detailed market studies and investigations on local availability of raw materials carried out by the NSDA, the construction of steel plant at Ajaokuta was commissioned and executed in 1979. The decree No. 60 of 1979 thereafter dissolved NSDA and created Ajaokuta Steel Company Limited, ASCL as its successor.

Ajaokuta Steel Plant Company, the biggest in Africa, located on 24,000 hectares and built on 800-hectares of land was conceived and steadily developed with the vision of establishing a Metallurgical Process Plant cum Engineering Complex with other auxiliaries and facilities. The complex was designed to generate important upstream and downstream industrial and economic activities that are critical to the diversification of the economy into an industrial one. It was also expected that the Company would take full advantage of the ECOWAS treaty and the Export Expansion Scheme of the Federal Government of Nigeria to expand its market base to the whole of the West African Sub-region and beyond.

Based on Blast-Furnace and Basic Oxygen Furnace (BF-BOF) Steel Production technology, the plant was expected to provide materials for infrastructural development, technology acquisition, human capacity building, income distribution, regional development and employment generation. As at 1994, the first phase of the complex was reckoned to be at 98% completion in terms of equipment erected by the original builder, Russian Company M/S Tiaj Prom Export (TPE). However, some completed units of the Plant had to short down due to non-availability of fund. Due to this non-completion and various legal tussles on the ownership of the Company, the plant has not been operating at its installed capacity level. So far, over $5.1Billion has been expended on the plant to date

II. Issue/Objective

Recently, a Russian Team of experts in conjunction with ASCL Technical experts carried out inspection and field assessment of the installed facilities and concluded that all the procured equipment for the completion of the project were remarkably well preserved and awaiting installation. They estimated the amount required for the complex to operate at full capacity to be USD1.2 Billion and therefore suggested that the Federal Government should make available the sum to complete both the internal and external infrastructure of the Company.

The basic objective of this study is to propose various finance options for the revitalization of the Company. We also present possible scenarios of combination of sources of funds

III. Comments on Financing Options

The government can finance the total Sum needed for re-vitalizing ASCL through supplementary budgetary allocations. However, this option increases government's fiscal deficit in the short term. An alternative to this option, is the Co – funding option. Here, the governments loans a fraction of the needed financing (say 75%, 50% 0r 25%) to AJSC at an interest rate equivalent to the over 12 months Treasury bill rate. The fraction of government's loan to AJSC will represent debt financing while the remaining fraction can be financed through equity financing – through private or public equity. The source of government's funding through loans could be from; Public generated revenue (tax revenues from Voluntary Asset Income Declaration Scheme (VAIDS)), and revenues from sale of governments idle assets. Sources of private placement arise from private institutional investors and fund managers, while public offer can also come from institutional investors, pension companies, insurance companies, fund managers and private individuals. Option 1 exposes government to higher financing burden, unlike options 2, 3 and 4 which reduces this burden. Options 2, 3 and 4 dilute the ownership structure of AJSC, however they allow for diversification of financing risk.

Options	Government Financing	Private Placement	Public Offer
	Debt %	Equity %	
Option 1	100	0	0
Option 2	75	10	15
Option 3	50	25	25
Option 4	25	25	50

Table 1: Debt and Equity options

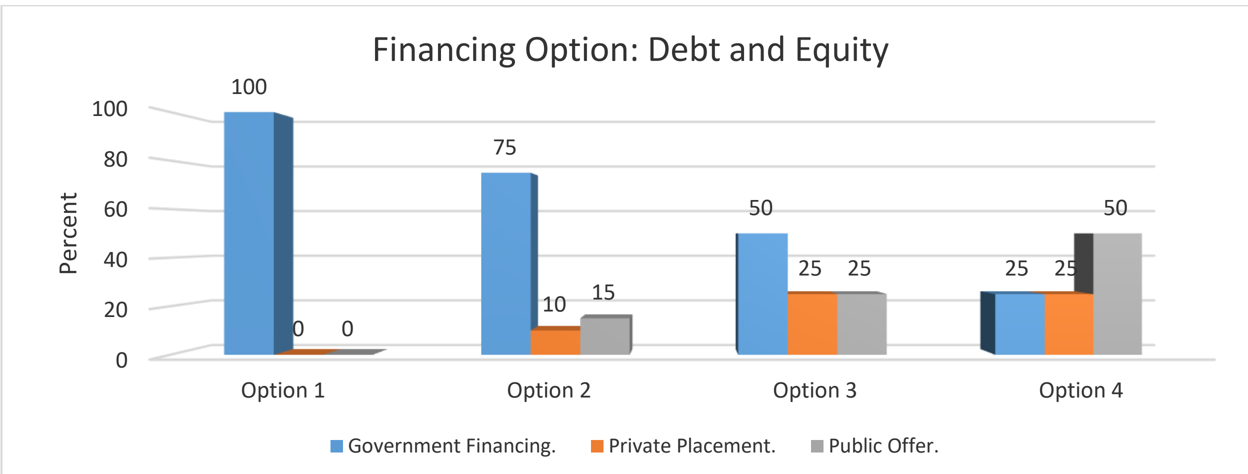

Figure 1: Debt and equity options.

Government can approach both interest and non – interest based development financial institutions, such as; World Bank, International Finance Corporation (IFC), African Development Bank, Islamic development Bank, Asia Infrastructure Bank and other multilateral international financial institutions. The government can borrow the whole sum needed for AJSC from either of interest and non – interest development financial institutions. However, funds from interest based development financial institutions have a higher cost of fund, and the conditionalities may be too stringent. On the other hand, funds from non – interest based development financial institutions have the advantage of having a cheaper cost of fund, and a major condition that the fund is tied to specific projects.

The government can also provide financing through the capital market. The government can float a bond, which may be a diaspora bond, a sovereign bond, a corporate bond or non – interest based bonds (Sukuk). Figure 2 presents combinations of financing options using bonds, equity and Sukuk.

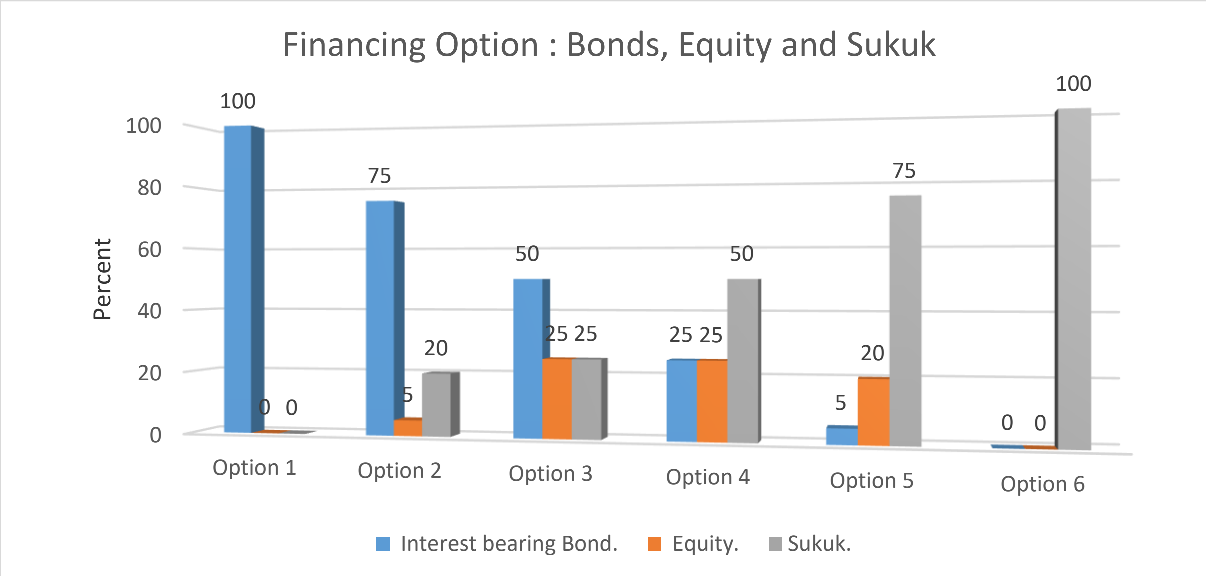

Figure 2: Various financing options

Another possible source of financing is through Excess Crude Account. As at January 2018, the balance in the excess crude account stood at $2.32 billion. Government could borrow from this fund for onward lending to AJSC at the prevailing Treasury bill rate.

Summary of Financing options and Their Implications

Source of Fund	Benefit	Cost Implication
Direct government funding through supplementary budgetary allocation	• Future dividends for the government to shore up her revenue generation and reduce deficits in the long run.	• Increase in fiscal deficit.
Interest based Development financing institutions	• Funds with long tenure with lower interest rates relative to domestic sources. • Reliefs the government of financial pressures.	• Future financial obligations because of the tenure. • Relatively expensive • Financial conditionalities attached before access to the funds
Non - Interest based Development financing institutions	• No future interest repayment burden • Less conditionalities • Opportunity to explore huge funds	• Future repayment obligations
Money Market (Commercial Banks)	• Raise short term working capital.	• High cost of funds • Crowding out of domestic private investment

Capital Market: Equity	• Diversification of risk • Dilution of ownership/economic interests for improved efficiency.	• Crowds out domestic private investment • Tilting towards private ownership.
Capital Market: Interest based Bonds (domestic)	• Opportunity to raise huge funds with long tenure • Lower interest rates relative to commercial bank funding.	• Crowds out private investment
Capital Market: non - Interest based Bonds (Sukuk)	• Must be tied to a project • No future interest repayment burden • Less conditionalities • Opportunity to explore huge funds	•Future repayment obligations
Capital Market: Interest based Bonds (international)	• Opportunity to explore a broad pool of international liquidity, with cheaper interest rates. • Inflation hedging	• Future repayment obligations
Sale of Government Idle Assets	• Cheaper source of funds • No interest payments / future financial obligations. • No conditionalities	• Ownership loss of such assets.
Recovered Loot	• Cheap source of fund relative to other sources	
Excess Crude Account	• Cheap source of fund	• The opportunity cost of using the funds for other socio – economic development
Pension funds and insurance funds	• long tenured financing	• Interest repayment burden.

IV. Potentials of Ajaokuta Steel Company Limited

The complex when completed and fully operational has the potential of:

- Generating revenue between US$1B and US$ 1.7 Billion per annum at full production
- Employing over 10,000 engineers and technicians and 10,000 other personnel directly
- Providing indirect employment for over 1,000,000 Nigerians
- Facilitating technological growth
- Producing inputs for the enhancing of infrastructural development

The views expressed in this Research Issue Brief are those of the author(s) and do not necessarily represent the views of the Institute and its Management.

Contact
National Institute for Legislative and Democratic Studies (National Assembly)
14/18 Danube Street, Off IBB Way, Maitama
Abuja, Nigeria.
Email: info@nils.gov.ng
Website: **http://nils.gov.ng/**
Tweeter: **@nilsnigeria**