MERCHANT BANKS AND EQUIPMENT LEASE FINANCING IN NIGERIA:

A CASE STUDY OF NAL MERCHANT BANK PLC

BY

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A THESIS SUBMITTED TO THE POSTGRADUATE SCHOOL, AHMADU BELLO UNIVERSITY, ZARIA, IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION

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DECLARATION

I hereby declare that this thesis has been written by me, and that it is a product of my own research work.

To the best of my knowledge, this research work has never been submitted either in Ahmadu Bello University, Zaria or any other institution for the award of a Degree.

All sources of materials and some other people's works and views drawn upon have been duly acknowledged by means of references.

Any mistake, whatsoever, in this work is entirely my own responsibility.

ARAGA ABDULLAHI ADEJO
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CERTIFICATION

This Thesis entitled **"MERCHANT BANKS AND EQUIPMENT LEASE FINANCING IN NIGERIA: A CASE STUDY OF NAL MERCHANT BANK PLC" by ARAGA ABDULLAHI ADEJOH** meets the regulations governing the award of the degree of Master of Business Administration (MBA) of Ahmadu Bello University, Zaria, and is approved for its contribution to knowledge and literary presentation.

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DEDICATION

This Thesis dedicated to my Late father. **MALLAM UMAR – FARUK ABDULLAHI ADEJOH ARAGA** for his affection and care, and also for not living to see the outcome and fruit of his labour. May his soul rest in perfect peace. (Amin)

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ABSTRACT

Merchant Banking is a recent development in Nigeria. However, the business continues to be attractive to a quite number of industries. This is so, due to rapid economic changes in the country, that results to high cost of machinery and equipment. As a result. Leasing as a form of financing the acquisition of capital assets has become a favourable option to our industries and very popular among the lessors and lessees alike in Nigeria. The paucity of information on leasing in Nigeria and the general lack of awareness on the part of the public as regards the financing of leasing are factors that motivated this research.

This study focused on the financing associated with leasing business and the inherent issue pertaining to such financing. For the study. both the primary and secondary sources of collecting data were used. The primary source of data involved personal contact with the lessors, especially some of the merchant banks in the country. While the secondary sources of data was used mainly for the review of the relevant literature on leasing.

As non - conventional way of creating funds for capital acquisition, equipment lease financing spread across to different sectors of the economy, mainly manufacturing, agricultural, construction, distributive and service industries. More recently, loan syndication is practice by merchant banks in order to meet the growing need of funds by bigger industries to acquire expensive equipment. This loan syndication provides a means whereby banks pooled resources to finance heavily cost machinery. Therefore, equipment lease financing tends to analyse the lessor - lessee relationship in respect to the type of contractual agreement they entered. Tax aspect, economic and accounting procedures of both lessor and lessee are analysed

To integrate series of economic reforms under Structural Adjustment Programme (SAP) and to consolidate further, other Federal Government Policies like Small and Medium Enterprises (SME) Scheme, all increase the desire of our industries to be committed to lease - financing as an alternative means to acquire an asset.

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CHAPTER ONE: INTRODUCTION

1.1 INTRODUCTION

INDUSTRIALISATION is an essential pre – requisite to the economic growth and development of any nation such as Nigeria. Apart from the fact that it ensures the availability of most of the manufacturing goods (besides those imported) and services, it also brings about the development of the vital sectors of the economy. But basic to Industrialisation is the availability of capital goods, which have to do with assets such as plants, machinery's and equipment.

Nigeria as a less developed country (LDC) has no technology with which to produce the desired capital goods as imperatives for the industrial transformation of the economy. Expectedly, the country has to depend mainly on the importation of such essentials. Unfortunately, the high cost of imported technology has denied most of the country's productive sectors and companies the necessary machineries and equipment with which production can be enhanced. The situation has not helped either by the devaluation of the Naira in recent times, especially with the introduction of the Structural Adjustment.

Programme (SAP) in the late 1980s, as acquisition of machinery and equipment becomes too expensive to finance.

Equipment lease – financing is a technology of acquiring asset for the purpose of running a business by a firm without incurring the cost of the asset. The increasing popularity that lease – financing method received is attributed to the advantages they offer compared to conventional system of financing. The most significant advantage of lease financing is that of lower cost of funds.

Once lease – financing is selected as the adopted financing method, the manager should be alert to factors that will ensure that the financing is planned, negotiated and executed to the advantage of the business. In executing these functions, the manager will call on the services of legal counsels, accountants, financial consultants, engineering and operative personnel, and other related specialised advisers.

Equipment lease – financing is a form of financial technique that firms use in order to acquire assets, financed by institutions such as investment companies, Development Banks, Saving Institutions, Commercial and Merchant Banks, etc. Out of the above mentioned

Institutions, merchant banks are one of the dominant lessors, even though merchant banking is introduced recently in Nigeria, one can argue that with economics changes, establishment of move merchant banks is encouraged in order to finance capital resources to different sectors of the economy.

Roads Nigeria Limited was the first customer in Nigeria to be granted equipment on lease, in order to carry out its construction functions by NAL Merchant Bank. Merchant Banks are becoming more attractive to leasing. For example in 1987, Nigeria Industrial Development Bank Limited became the first bank in the industry to set up a fully owned subsidiary in leasing business.

Equipment lease – financing in also becoming attractive to lessees, whose growing need of funds in fast increasing, especially with series of economic reforms in the country e.g. Structural Adjustment Programme which forced the prices of machinery to be high, as such lease option is gradually gaining ground among our industrialists.

Equipment leasing provides an opportunity whereby the lessor and lessee enter into contractual agreement based on the contract terms, lease rates and equipment to be leased, however in all cases, the lessee is expected to make a series of rental payments to the lessor

for return of having economic use of an asset.

1.2 STATEMENT OF THE PROBLEM

With the series of economic changes in Nigeria, especially during the period of Structural Adjustment Programme, purchase of imported machinery and equipment become difficult, as such leasing could be a favourable option to acquire these assets.

However, a number of constraints in Lease – Financing as an alternative form of financing attracts many publications by different personalities, including Bank executives, government officials and private individual businessmen. The constraints centres on: credit ceiling under credit policy guidelines designed by the Central Bank of Nigeria, and its subsequent review serve as a serious drawback to lease transaction; the size of equipment lease financing in Nigeria has remained relatively small due to the unimpressive role of Merchant Banks in this regard; the constant review of Monetary Policy affect the ease or difficulty in securing funds under lease arrangement, due to fall in value of the Naira; the equipment leasing industry in Nigeria has been largely dominated by Merchant Banks; the financial position of Merchant Banks does not guarantee the condition for honouring

growing number of applicants and the discrimination of Lessees by the NAL Merchant Bank Plc. affects the distribution of equipment on lease to different sectors of the economy and further creates pending applicants.

These and other related problems are what this research aim to analyse.

1.3 PURPOSE OF THE STUDY

The central theme of this study is to examine the extent to which Merchant Banks, (particularly NAL Merchant Bank Plc) are engaged in equipment lease financing in Nigeria.

The specific purposes of this study are:

1. To examine the conduct of NAL Merchant Bank Plc in relation to leased equipment as it applies to different sectors of the economy.
2. To evaluate leasing as a non – conventional means of asset acquisition, bearing in mind lessee – lessor relationship in terms of attractiveness of the transaction.
3. To evaluate loan – syndication and find out what advantages and disadvantages it has to both the primary sponsors and the

secondary sponsors.

4. To examine leasing as a financial tool and alternative to buying.
5. To identify the constraints faced by NAL Merchant Bank Plc in lease financing and the possible solutions.

1.4 SCOPE AND JUSTIFICATION OF THE STUDY

This study covers the concept of leasing which reveals different forms of leasing financing between lessor and lessee. This transaction is undertaken in respect of the following units:

1. Operating Leasing
2. Financial Leasing
3. Leveraged Leasing
4. Loan Syndication Unit

Operating leasing is a medium term commitment that allows the lessee to use an asset for a fraction of the life span of an asset.

Financial leasing on the other hand is long term agreement between lessor and lessee to acquire an asset for most of its life span.

Leveraged leasing is a lease transaction that usually involves three parties namely: lessor, lessee and any other institutional investor.

Loan syndication is an arrangement that involves more than one lessor. Here, the leader lessor, will co-ordinate the transaction between lessor(s) and lessee for the purpose of asset acquisition to service various industries in the country. These industries include:

1. The manufacturing industry
2. The transport industry
3. The agricultural/Mining industry
4. The Distribution industry
5. The service industry
6. The Construction industry
7. Others.

The study further covers the total value of the equipment acquired through lease financing by various industries and the rental payments received during the reporting period i.e. 1997 and 1998 financial years.

The financial manager of any corporation is expected to deal efficiently with all financial matters of his organization, which include

realising sources of capital acquisition and other possible alteration open to the business to that effect.

Leasing being one of the options of asset acquisition through contractual agreement between lessors and lessees has a significance role to play. The desire to undertake this research work is therefore borne out of the fact that. the study will assist in improving the understanding of contractual relationship within the legal and financial capacity of lessor and lessees.

Equipment lease financing is a new development in Nigeria. therefore fundamentally this study will improve the awareness to both lessors and lessees on lease financing. This research work is also important. because it exposes the risk – minimisation tendency to both lessors and lessees. fundamentally this tendency dictates the manners of lease arrangement right from the inception.

Lastly. the study definitely is important to the Bankers. business organisations and to individual investors who may be interested in acquiring assets through lease arrangement at the advantage of their respective businesses or act as lessors in case of Bankers.

1.5 SIGNIFICANCE OF THE STUDY

Equipment leasing has been identified as a veritable means for the industrial transformation and the general economic development of the less developed countries. Moreso. in Nigeria its esteem position in our economic development in recognised.

As it were. the business of leasing in the country is undeveloped and unpopular. This. owing partly to the fact that there is the general paucity of information and the lack of indigenous literature on the financing of the business.

The study of this nature. therefore. is meant: to provide the operational frame work of the financing; to provide the descriptive information of leasing transactions; to give in sight into the legal. accounting and taxation aspects of the financing; to highlight the peculiar favourable factors for and the constraints against leasing business in the country; and to analyse the bases of disagreement and dissatisfaction of the financing in Nigeria.

Above all. the study is meant to provide more literature and contribute to the existing knowledge on the subject matter.

Lastly. it is hoped that the finding of this study will be of interest and benefit to the lessors (the financiers). the lessees (the beneficiaries).

the government and the academics for further research in an attempts to update the available literature on the subject matter.

1.6 LIMITATIONS OF THE STUDY

Basically, all research work of this nature must have limitations. The first limitation of the study was the cost involved, as all data used for this study were obtained in Lagos, which is very far from Zaria, as such the travelling expenses, to and fro to Lagos was not and easy task; and this is necessary because the branch offices of Equipment Leasing Association of Nigeria (ELAN) and NAL Merchant Bank Plc in Kaduna do not have the necessary data.

Human error and sentiments were other limitations considered; because information obtained and series of discussion held with people are sources of data used, as such there is possibility of human error of commission or omission.

Equally important on the limitation are the reliability and validity of the data obtained from respondents. These respondents may exaggerate or hide some important information in order to portray a good image of the organization.

Despite all these constraints, quite a lot has been dome on the study, which clearly improve the understanding between Merchant Banks

and Equipment Lease – Financing in Nigeria. The study will further serve as a basis for subsequent research work on the topic or other related areas.

1.7 DEFINITION OF TERMS

Merchant Bank:

Merchant Bank can be defined as wholesale financial institution. licensed under the banking Act of 1969: as a merchant bank. it is expected to engaged in medium and long – term transaction into different industries like manufactùring. transport. etc.

Industrial Financing:

This term is used to refer to the raising of capital for firms engaged in the productive sectors of the economy through lease financing.

Lessee - Lender

Lessor – Borrower

Lease – Alternative means of asset acquisition by a firm without paying for its cost.

Collateral:

Any equipment that is leased.

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Finance Lease:

A financial device whereby a user can acquire the right for the use of an asset for most of its useful life.

Operating Lease:

A short - term lease whereby a user can acquire the right for the use of an asset for a fraction of the useful life of the asset.

Residual Value:

The value of equipment at the conclusion of the lease term.

Renewal Option:

An option to renew the lease at the end of the initial lease term.

Real Property:

Simply refers to land, building or part of any that is being leased.

Rental Payment:

This refers to series of payments made to the lessor by the lessee during the leased period.

Leveraged – Lease:

A lease in which the lessor borrows a portion of the purchase price of the leased equipment from institutional investors.

Lease – term:

The contractual manner in which the lease agreement is signed by both the lessor and the lessee.

Lease – Rates:

This is the interest rate at which lessor charge the lessee based on the contractual term of the two parties.

Fair value:

This refers to annual selling price of equipment less volume of trade discount.

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CHAPTER TWO: LITERATURE REVIEW

2.1 EVOLUTION AND GROWTH OF LEASE FINANCING IN NIGERIA

Really, there is not much literature on Equipment leasing because it is a new development in the country, and this has made it rough to trace with some level of accuracy, the history of leasing in Nigeria.

However, prior to the imposition of the exchange control measures in the wake of the civil war (1967), Nigerian subsidiaries of British Companies was gained from off shore leasing, direct from British lessor companies. Given the degree of Industrialisation in Nigeria that time, the volume of stock exposure was predictably low.

By the year 1972, two locally incorporated companies namely: NAL Securities Limited (subsidiary of NAL Merchant Bank Plc) and Bentworth Finance of Nigeria Limited were offering a limited amount of Leasing facilities within Nigeria.

With the post – war reconstruction and increased earnings from oil exports, the country embarked on Industrialisation programme that required heavy investment outlay in capital assets. Instead of outright purchase of heavy equipment needed, a large number of contractors, mostly foreigners preferred to lease them. Fortunately, due to the

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desire to setting up more industries in the country. numerous Merchant Banks were encouragely set up to provide medium and long term finance to the growing industries.

To facilitate lease transaction in the country a body known as Equipment Leasing Association of Nigeria (ELAN) was formed in 1983 with six registered members. But. by 1998, the association has forty-eight fully pledged members. This association, apart from mediating transaction between lessors and lessees. also engages in organising workshops. and seminars on leasing to interested participants.

Statistics has shown that. the net book value of equipment on lease as at December, 1998. amounted to N1.15 billion.

This is a remarkable growth rate, if compared with the real value of equipment on lease estimated to be N701.2 million (ELAN Annual Report and Accounts. 1989 – pp.19).

This growth in the volume of leasing business occurred against the background of the most important changes in the Nigeria economy.

These changes include:-

A. The introduction of a deregulation interest rate structure in the wake of credit ceilings made leasing an attractive investment to

lessors.

B. The encouragement of backward integration programme for manufacturing sectors of the economy supported by the ban on selected raw – materials. this led to search for local substitutes. and setting up of new projects to explore these potentials was therefore inevitable. as much more finances were needed to secure new assets. Thus. leasing becomes a good option to the manufacturers.

C. The introduction of the foreign exchange markets resulted in the devaluation of the Naira within a free trade atmosphere. This meant that financing of imported capital assets is now necessary and easy for lessee.

D. Government deflationary fiscal policy which placed restriction on the credit expansion of both merchant and commercial banks. This strengthened the position of leasing as an alternative means to finance capital resources.

E. The establishment of Equipment Leasing Association of Nigeria (ELAN) which increased awareness through symposium. seminars and lectures to both lessors and lessees to the advantage of leasing as an alternative form of financing.

2.2 A CONCEPTUAL FRAME – WORK OF EQUIPMENT LEASE - FINANCING

The concept of leasing is fraught with many definitions. Nonetheless, all such definitions recognise that the concept revolves around an asset which brings some two parties into agreement (a contract) with one party giving out the asset and the other party taking possession of it on rental basis.

A lease is an alternative means by which a firm acquires the economic use of an asset for a stated period of time.

Leasing defined by Baker and Hayes (1946) as " a method of financing acquisition of property". Leasing therefore can be seen as a way of acquiring an asset through agreement between the lessor (owner) and the lessee (the user).

The Equipment Leasing Association of Nigeria (ELAN) defined leasing as,

"a contract between lessor (e.g. a Merchant Bank) and a lessee (a Company) giving to lessee the possession and use of specific assets on payment of rentals over a given period. The lessor retains the ownership of the assets so that it never becomes the property of the lessee or any related third party during the tenure of the lease".

The concept of leasing has been described by the Equipment Leasing Association of Great Britain as

"a contract between lessor and lessee for the hire of a specific asset selected from a manufacturer or vendor of such asset by the lessee. The lessor retains ownership use of the asset. The lessee has possession and use of the asset on payment of specified rental over a period".

Lease financing can be categorised into different forms. The categorisation depends upon the signed agreement by parties involved. This not withstanding, the lessee in all cases makes a series of payment to the lessor. The lease contract specifies the manner of payment. even though payment is usually due immediately after the contract is signed. In the event of breach of contract that can lead to contract termination, the lease equipment becomes the property of the lessor. However, lease arrangement gives an option to the lessee of either to purchase the equipment. or to undertake a new lease. These lease arrangement involves financial institutions on one hand, while on the other hand, it involves manufacturing, service, agricultural and exploration industries.

Generally speaking therefore, lease financing techniques and terms of contract differ depending on the lessor, the equipment leased, the length of the lease and the prevailing interest rate. It is important for managers after evaluating and selecting lease financing as a preferred techniques to ensure that, the feasibility of the equipment must be determined and this should be proceeded with further analysis on the following:

1. Feasibility under the lessee's corporate indenture and other credit documents.
2. Feasibility of the asset itself, which should have a market value and should not quality as a bondable property, which can be used as a basic for future bond issue.

2.2.1 Equipment Lease Financing – Contractual Terms

Majority of lease contract last between 3 – 10 years. Long leases only occur in special cases, and when it does, it calls for lease of excellent financial statute. However, equipment such as computers, air conditioners, furniture's, cars, etc. are normally leased for a period under 3 years. – (Richard Breadley, 1985). This writer further advanced that, after the expiration of the initial term of reference,

there are usually three alternative. namely:

1. Start a new lease with a new piece of property.
2. Purchase the property outrightly for some residual amount.
3. Review the lease under an option that generally allows for a reduced rent rate.

The first option involves a new contractual agreement between the lessor and the lessee bearing in mind the cost and efficiency of the equipment. items like photo copiers. computer, etc can easily become obsolete. especially with rapid changes in technology.

The second alternative involves fair market value of equipment after the termination of contract. However, estimation of residual value is a difficult task. but most firms estimate residual value by using the ratio of current second hand price to the value of that equipment it had when it was new. This ratio when multiplied by the price of the new equipment will give a fair residual value.

The last option of renewing lease contract at reduced rent rate is obvious. in that the leasing company has recovered all of its original investment. as such it can afford to make leasing less expensive.

2.2.2 Lease Rates

Lease rates vary widely: it depends on the risk involved. Generally speaking, the more specialised the equipment or the longer the term of the lease, the higher the risk to the lessor.

Many authors have recommended different approaches in calculating lease rates. For example, Willard T. Carleton (1986) recommend add – on – interest approach determining lease rates. In the approach, the add – on – percentage is multiplied by the contract term over the years to the total change.

In calculating lease rates, Koutsianias (1976) advanced that lease rates can be determined by using simple interest method. Here, the percentage is multiplied with both the value of the equipment anc lease period.

In the add – on – method, it is often quoted as a separate increment to the contract while in the other approach, the lease rate is quoted on a certain percentage of the original equipment cost per month.

In a situation where the lessee has a high credit rating, lease agreements may be written on simple interest, where the term may range from 7 to 13 percent or even higher simple interest rating.

The interest charges is rationale, because the new equipment is purchased from a manufacturer at a standard price, as such the leasing company is making available 100 percent loan to the lessee. To reduce risk, the lessor may require to put up a lease deposit. This lease deposit is usually equal to the first month's rent (lease payment) plus one additional month's rent for each year of the contract life of the lease. Some lessors, however, requires only first and last months rent, but then require a "Set – up charge" or "Security deposit" in addition.

2.3 TYPES OF LEASE ARRANGEMENT

There are various types of leasing which can be arranged between the lessor and the lessee. In other words, there abound some various leasing schemes as designed by the lessor, but J. Van Horne (1986) proves that all lease – financing arrangement fall into one of these first – three categories. These are analysed below:

1. SALE AND LEASE BACK

This arrangement involves the sale of an asset, say, land or building already owned by a firm to another organization, and then the very same firm leases the property back for a number of years.

By this arrangement, investors have new outlets for investment funds.

and the business firm can devote the funds realised to other commitments such as inventories, current operating expenses, and accounts receivables.

The arrangement usually gives the lessees option to have the lease extended for additional periods for which the rental payments are materially reduced.

Moreso, since the investment institutions such as Insurance companies, Merchant Banks, etc are expected to recover the full amount of their investment with interest during the original period of the lease, the agreement does give the lessees the further option of buying back the property at the expiration of this period.

2. DIRECT LEASING

Under this arrangement, an organization takes possession, for use, of an asset it did not own previously. Firms can acquire capital goods for use from the manufacturers; these range from computers, vehicles, air crafts, machine-tools, oil tankers to air conditioners, among others. As more capital goods are available for leasing, there are also a wide variety of direct leasing arrangements available to meet the various need of a firm. The major types of lessors are manufacturers,

Merchant Banks and Independent leasing companies. However, in some cases, vendors buy from manufacturers and sell the equipment to lessor who will in turn lease it. Economies of scale are sometime possible on purchase of capital asset by the lessor, of which these economies of scale can be passed to lessee in form of lower lease payments.

3. LEVERAGED LEASING

Leveraged leasing is a recent developed form of leasing in conjunction with the financing of assets requiring large capital outlays. In contrast to the above mentioned leases, where two parties are involved, leveraged leasing involves three parties namely:

A. The lessee

B. The lessor or equity participant

C. The lender

J. Van Horne (1963) argued that, from the lessee's stand point there is no difference between a leveraged lease and any type of lease. The lessee who signed contractual agreement must makes series of payment to the lessor for the return for the economic use of the asset over that lease period. However, to the lessor, the role is different.

The lessor acquires the asset in keeping with the terms of the lease agreement. This acquisition is financed in part by an equity investment by the lessor of say 30 percent (hence the name, equity participant). The remaining 70 percent are provided by long term lenders. The loan is usually secured by a mortgaged on the asset, as well as by the assignments of the lease and lease payments. The lessor, however, is the borrower.

The lessor is entitled to deduct all depreciation charges associated with the asset, as well as to utilise the entire investment tax credit, by virtue of him owing the asset. And the cash flow pattern for the lessor typically involves:

1. Cash outflow at the time the asset is required, which represents its equity participation.
2. A period of cash inflows represented by lease payments and tax benefits, less payment on the debt.
3. A period of net cash outflow where due to declining tax benefits, the sum of lease payment and tax benefits fall below the debt payment due. If there is any residual value at the end of the lease period, this of course represents a cash inflow to the lessor.

4. FINANCIAL LEASE (OR FULL PAYOUT LEASE)

This type of lease is also known as capital lease. Under the agreement, the possession and all the responsibility of ownership are passed on to the lessee who takes care of the maintenance and insurance of the equipment.

The lease is fully amortised, that is, the lessor receives rental payments equal to the full price of the equipment under lease plus a return on investment.

The agreement is not cancelable and may contain a right of option to purchase by the lessee for a nominal sum at the expiration of the lease period.

5. SALES TYPE LEASE

This type of lease agreement is relatively a recent innovation, which is aimed at promoting sales of manufacturing products.

It is a type of lease where a manufacturer is the lessor. The lessor transfers the ownership risks as well as benefits such as capital allowances to the lessee in return for periodic rental.

6. SYNDICATED LEASE (CONSORTIUM LEASING)

This type of lease involves more than one lessor and it usually occurs when the value of the equipment to be leased is too high for one lessor to handle.

The lead lessor invites other lessors to participant in financing discrete equipment out of the many to be leased to the lessee. Each lessor claims capital allowance on the discrete equipment it has financed.

It is also possible for the lessors to finance on single equipment jointly. Being recognised by the Inland Revenue department, the lessor would be allowed to claims capital allowance on the proportion of the qualifying expenditure equal to the amount incurred by each of them in acquiring part of the asset.

7. VENDOR LEADING ARRANGEMENT

This is a sale – aid arrangement through which equipment manufacturers or distributors can offer lease finance to their prospective customers as integral part of their sales and marketing programme.

The principle is that salesman will find it easier to sell a piece of equipment to a potential client if he can offer him a quick and cheap method of financing the purchase

The type of equipment normally associated with sales – aid leasing is office equipment such as photocopiers. fax machines. word processors. and the like.

8. CROSS – BORDER LEASE

This is a leasing arrangement in which the lessor and the lessee operate in different countries. It is more or less an export transaction. The equipment involved is shipped to a foreign country but remain the property of the domestic leasing company. At the end of the lease period the equipment is normally purchase by the lessee.

Some of the problems associated with the cross – border leasing arrangement include: Applicable law: currency problems; exchange controls; import and export permits and duties; income and with holding taxes; and different accounting requirements.

2.4 COMPARISON OF LEASING WITH BUYING

For the comparison of the option of leasing an equipment with an outrightly purchase, there are certain bases that are normally used as analysed below.

1. Cost Financing

Considering whether lease financing or borrowing is better depends upon the patterns of cash outflows of each financing method and upon outflows of each financing method and upon the opportunity cost of funds

Discounted cashflow techniques is used to evaluate lease or buy proposed. For the evaluation, the following elements are considered:

i. Details of the lease and loan contracts

ii. Cash flow associated with lease rentals rate of a loan repayments

iii. Interest rate of a loan

iv. Any residual payments associated with lease option.

A quantitative example is provided below:

Additional equipment is required by a certain firm to increase the volume of production of its product. The economic (useful) life of the equipment is five years. The cost of the equipment is N120,000.

To lease the equipment involves an annual rental payment of N34,000 for five years.

A loan of N120,000 to buy it attracts an interest rate of 10 percent. The required annual payment is:

R = Amount of loan ÷ PVF of 10%, 5 years

R = N120,000 / 37,908

R = N31,656

To lease cost N34,000 annually. To borrow for buying cost N31,656. It is cheaper to borrow for buying the equipment; based on the calculations above.

Using a 15 percent hurdle rate (weighted average cost of capital) as a discount rate, the net present value analysis is:

Time	Cash flow	PVF @ 15%	Present value
0	-N120,000	1.0000	-N120,000
5	N35,000	3.3522	N117,327
	Net present value	=	-N2,673

The net present value of acquiring the equipment is negative using the hurdle rate leasing the equipment gives a positive net present value.

Net benefit of borrowing to buy		= -N2,673
Net benefit of leasing is	N35,000 – N34,000	= N1,000
And @ 15%, N1,000 is		= N3,352

Leasing is acceptable: it is cheaper than borrowing to buy the equipment.

Using the straight – line tax depreciation and after tax borrowing rate of 6 percent, assuming that the lessor offers to lease at N31,656 per annum, the same as the debt service if the money is borrowed. Depreciation for 5 years, without salvage value is N24,000 annually

Assumed tax rate if 40 percent

Cost of borrowing to buy is:

Cost of equipment – tax rate (depr.)PVF of 6%, 5 years

N120,000 – 0.4 (24,000) 4.2124

N120,000 – N40,439 = N79,561

The figure of N40,439 represents the present value of the tax savings resulting from the use of straight – line tax depreciation.

The after – tax present value of leasing is:

Lease rental (1- tax rate) PVF of 6%. 5 years

N31.656 (1 - 0.4)(5.0.06)

N31.656 (0.6)(4.2124) = N80.009

Borrowing to buy the equipment has a smaller after – tax present value cost than does leasing.

The factor of (1 – tax rate) PVE annuity (5 years. 6%) is used for present value of leasing since the after –-tax borrowing rate is being used as the discount rate. This makes the calculations for leasing, the after – tax borrowing rate is being used to discount all the cash flow.

2. *Periodic payments*

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An important advantage that lease has over other types of financing options is that it is flexible.

The periods of the lease, the rental can be arranged to suit the needs of individual lessee. The rentals can be small at the beginning and increase gradually to the end of the lease period.

Such is the case with the option of loan. Only the bank determines the interest payment. This same thing applies to the magnitude of

repayment and the time period within which the loan is to be liquidated.

3. Contractual Requirements

In most borrowings for capital projects. a loanee is expected to provide a proportion of the capital outlay. For a firm to enjoy this facility. such hurdle must be surmounted.

In a situation whereby a company is financially stretched to the limit already this contribution might not be difficult to raise. In such condition. leasing has a decisive leverage over loan as a hundred percent finance can be provided.

Moreso. the requirement for a compensation balance. which is kept with the bank out of the amount of loan granted makes loan financing more costly than leasing. This is because the firm is not in any position to make use of the whole amount of loan and still. it has to pay interest on the whole loan.

In the case of leasing. no additional collateral is required but a collateral security is required to be pledged even before a loan facility is granted.

4. Repayment Terms

Loan financing is associated with rigid and usually regular repayment terms. Leasing has an element of flexibility in the repayment arrangement. Lower payments at the early part of the lease and higher payments at the later part of the lease period.

To this end, leasing which is properly arranged can provide an effective hedge against inflation. Cheaper Naira can be used in making the latter and heavier part of the lease payments.

5. Availability of Equipment For Purpose

Certain facilities are not available for outright purchase unless on lease hold basis.

Since such equipment can only be procured and used through leasing arrangement, lease option prevails over borrowing to buy. It means that since the equipment cannot be purchased, the consideration of borrowing to buy does not arise.

6. Replacement of Equipment

Leasing arrangement makes it easier to replace and modernise equipment. In this development. the lessee has ready access to the latest technology that is easily acquired through the replacement of the old equipment.

- Ownership of equipment through borrowing to buy tends to retard modernization since the firm has to make do with the old type since replacing it calls for another loan that may not be forthcoming.

7. Duration of Use

Some companies may wish to use some equipment on a short – term basis rather than employing such facilities for so many years. This arises out of the prevailing economic circumstances. and most companies' d o not wants their resources tied up fixed assets during a period of recession.

Given such consideration, leasing of equipment is most desirable as compared to owing such facility through borrowing to purchase.

8. Equipment Maintenance And Spare Parts

Leasing does afford the firm to have ready access to maintenance and spare parts for the equipment under lease. For the maintenance, the lessor company does maintain an outfit to take care of leased equipment for the lessee.

Under leasing arrangement, in essence, maintenance of equipment is rest assured. And the Lessor Company that has to service and repair the leased equipment makes the availability of spare parts easy. Maintenance and Procurement of spare parts for equipment under outright ownership do pose some serious burden and problems to the firm.

2.5 DRAWBACKS OF LEASING

There are certain problems that are associated with leasing and they are then highlighted below:

1. The lessor can be left with damaged equipment if such could have been handled carelessly by the lessee.
2. Some lease arrangement can be very complex.
3. It constitutes an element of risk of operation for the rentals must be paid in the face of operational adversity.
4. Property taxes are likely to be built into lease payments.

5. Rental payments can be more than the total amount of expenses of maintenance. insurance and depreciation of free hold property.

6. A lease may prevent other debt financing if it is a firm's obligation to pay the rental charges.

7. Probability of the lessor bearing the cost of obsolescence in the case of the cancellation of operating leases.

8. Absence of residual value if the life of the property is longer than expected.

9. The lessor has to do a lot of paper work that involves some administrative costs.

10. The insurance and maintenance expensive can be built into the rental charges.

11. Loss of depreciation and investment tax credit on the part of the lessee.

12. Later incomes are less especially with the option of having the term extended upon the expiration of the origin term.

2.6 LEGAL ASPECT OF LEASE – FINANCING

From legal point of view. William D. (1978) observed that lease financing could be divided into three major categories namely:

A. Sale-lease back of real property Chattel leases intended as security agreement

B. True leases of personal property

The first category involves signing an agreement between lessor and lessee on real property such as land, buildings or even part of the buildings, while the second category encompasses leasing of practical equipment such as computers, aircraft, etc. And lastly, third category involves leases of personal property.

Codified laws, acts and guidelines are normally enforced to direct the practice of leasing business, that the rules essentially will be acceptable e.g. all long term leases must be in writing. Unfortunately, laws in Nigeria are silent in most aspect of lease operation, as such many individuals are calling the attention of the government to that effect. E.g. Mr A. O. Ogunmefun (1989) who inferred that "Merchant Banks have come of age in lease financing as such, codified law on leasing in Nigeria should be enacted, in order to avoid existing grey areas in lease transaction."

However, some important legal aspects of lease financing used to be evaluated as follows:

2.6.1 Lessee's Obligation to pay Rent

Lease contracts always contains an express promise known as a convenant which binded the lessee to make a series of payments in specified amount at a specified interval for a period of times. In the absence of this convenant, the implied obligation stipulates that rent should be paid to the tune of reasonable amount and this is payable only at the end of the term.

Any breach of contract by the lessee, will entitled the lessor to decline the lease at the expiration of the agreement and will give him the right to regain possession of the property for breach of any of the convenants.

2.6.2 Termination of the Lessee's Obligation on Rent Payments

The implied condition to pay reasonable rent by a lessee cease to exist, when the lease hold is transferred by assignment. Thus, when the lessee assigns a lease that does not contain an express agreement to pay rent, the implied condition to pay reasonable rent

passes to the assignee. This is not true where the lease contains an express agreement of the lease to pay rent.

Under an express convenant to pay rent, the lessee remains liable despite the fact he has assigned the lease hold to another lessee unless the lessor releases him from the obligation.

2.6.3 Effects of Destruction of the Property on the Lessee's obligation to Pay Rent.

Richard and Myers (1981) reported that most leases contain clauses covering the fortuitous destruction of the premises. A typical clause provides that, on damage by fire or other fortuitous cause, the lessor will repair and restore, and that if the premises are wholly unusable the lessee's obligation to pay rent will be suspended until the premises are restored, but that if the lessor decides to demolish and reconstructs the premises, the lease will terminate.

2.6.4 The Obligation to repair and restore

The lessee is under no duty to make any repairs to the property, unless the lease expressly provides. Also the lessee is jot obliged to repair or restore substantial or extraordinary damage occurring with fault or to repair damage caused by ordinary wear and tear.

2.6.5 Expiration of the Lease Agreement

A lease for a definite term expires at the end of the term by virtue of its own limitation. Most leases financing agreements are for a definite term.

2.7 TAX ASPECTS OF LEASE – FINANCING

When an intended lease is treated as a lease for Federal income tax purposes. the lessor reports the rental receives from the lease transaction. while the lessee receives a deduction for expenses. as stated in s. 162(a)(3) of the Internal Revenue Code (1954).

The lessor also retains the right either to depreciate the asset or to receive investment tax credit or to pass through the credit to the lessee. However. if a lease is treated as conditional sale. the lessee will be entitled to a depreciation deduction on the property. but not a rent reduction. The lessee's depreciation deductions will be computed over the period that could be described as the useful life of the property and not simply over the lease term.

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Lease arrangement do not always representing rental contracts within the framework of financial reporting and federal tax requirements.

Many lease agreements are in substance. conditional sales contracts. In such conditional sales cases. the lessor will require to recognise a sale. while the lessee will record a purchase. In addition. the lessor as the owner will record all the accounting entries pertaining to a sales agreement. that is depreciation. interest expenses and any investment tax credit.

Financing reporting and the tax requirements are similar in having regard to the accounting treatment of lease agreements that have been classified as sales. Differences do exist in the determination of such classifications. and in the treatment on interest expense. The four criteria that determine whether a lease will be classified as a sale or a financing relates to ownership. purchase option. economic life and lease payments.

2.8 ECONOMICS AND ACCOUNTING ASPECTS OF LEASE – FINANCING

Various Economists recognised true value of money. which us usually referred to as interest. These economists view business as the ability to Co – opt capital. raw materials and labour to produce at minimum cost and consequently maximise profit. At this juncture. lease or buy

decision is analysed on the interest rate over the acquisition of an asset.

Several scholars, such as Baker et al (1946) provided economic reasons for leasing in their studies. Some of those reasons are:

1. Transfer tax benefits to those who can use them most appropriately.
2. Provide use, rather than ownership of assets that have relatively short lives.
3. Provide access to assets when ownership is difficult.

The secondary economic factors that facilitates ease finance transaction could be analysed as follows:

In a capitalist economic, like Nigeria, when entrepreneurs will gain economic control of scarce resources, for example, oil bearing properties, timber, land, etc, and then exploit such assets until market demand is exhausted. Leasing is a means of gaining such economic control. Hence, entrepreneurs may have desirable assets, although they will not sell such assets, but they will lease them out.

Other economic advantage of leasing is that it provides a chance of obtaining asset quickly, especially if it involves government where debates, deliberations and sometimes voting has to be carried out before final approval for purchase. Rapid technological innovation is an advantage to lease, because of risk of obsolescence may be assumed by a lessor who is able to spread such risk among a number of lessee's and over spread such risk among a number of leasing and over multiple assets. In addition, equipment leasing can provide flexibility that may not be available through other methods of financing, e.g. lease contracts often do not have restrictive covenants against further debt. To the extent that s source of financing through leasing is made available to firms that are unable to secure financing from conventional sources, leasing tends to smooth out imperfections in capital markets.

2.8.1 Lessee Accounting Procedure Under Lease – Financing

Under a lease agreement, the lessee does bot have legal title to the leased asset during the period of the lease. However, as regards to finance leases, the realities are that in return for an obligation to pay amount which approximately to the fair value of the leased asset and the related finance charge, the lessee acquire most of the benefits of

term and the initial recorded liability, the latter being the same as the value of the related asset at the inception of the lease. The finance charge should be allocated to income on a systematic basis so as to produce a constant periodic for each period.

Lastly, the depreciable amount of a leased asset should be allocated to each accounting period during the period of expected use on a systematic basis that is constant with the depreciating policy, the lessee adopts for depreciable assets that are owned.

In consideration of the operating lease, the International Accounting Standard number 17, states that details of the leased asserts are not recorded in the books of the lessee. Instead, the lessee will charge against the income of a period an amount that represents rental expenses on the leased asset. If details are available charges and finance charges for separate disclosure in the financial statements. Rental expenses should be recognised on a systematic basis that is representative of the time pattern of the user's benefit. Therefore, the basis for rental payments may be different from the basis adopted in charging rental expenses against income in the same accounting period. Any differences between the two amounts will be included in

debtors and creditors as appropriate. Amounts for rental expenses should be separately disclosed from related cost or services, such as maintenance and insurance that should be charged to income as and when incurred.

2.8.2 Lessor Accounting Procedure Under Lease – Financing

As regards to finance lease, the value of an asset should be recorded in the balance sheet of the lessor as receivable as an amount equal to the net investment in the lease transaction, that will aggregate minimum lease payments less unearned finance income. The lease rentals receivable are therefore treated as repayments of principals and finances income which are intended to reimburse and reward the lessor for his investment and services. The portion relating to this principal is applied in reducing the balance of the receivable outstanding while the finance income should be included in income as appropriate.

S.5c of the International Accounting Standard of number 17, states that finance income should be allocated on a systematic and rationale basis on a pattern to reflect a constant periodic return on the lessors net investment outstanding or net cash investment. Since different

results can be obtained from the use of net investment and net cash investment (cash outflows less in flows) excluding amounts rechargeable to the lessee. Initial cost incurred by the lessor and not recoverable from the lessee, such as commissions and legal fees should either be expensed immediately or allocated against finance income or the lease term. There should be consistency in the method adopted.

A variation of a finance lease is leveraged leased where there are three parties: the lessee, the lessor and one or more long term creditors.

Under the term of leveraged leases, the third party long term creditors, generally does not have recourse to the lessor for finance provided by them. The lessor would therefore record his investment in the lease net of the non – recourse debt and the related finance costs to the third party creditors.

Another form of finance lease is where a manufacturer leases an asset. This will give rise to two types of income:

a. The profit or loss equivalent to the profit or loss resulting from an outright sale of the asset being leased at normal selling price and with the applicable volume trade discount.

b. The finance income over the lease term.

Profit should be recognised in accordance with the policy normally followed by the manufacturer for sales. Efforts should be made to ensure that an excessive portion of the total income is not recognised at the time of sale by the adoption of artificially low interest rate for the finance income. Initial direct costs to be borne by the dealer lessor are usually charged to income at the inception of the lease.

Under the operating lease, S. 129 of the International Accounting Standard number 17 stated that, the leased asset is recorded by the lessor as repreciable asset in its books at cost or at the present value of the minimum lease payments, and rental income is included in income over the term of the lease. Rental income is normally recognised in a straight line basis over the term of the lease, even though actual receipts are not on such basis of the differences being debtors and creditors as appropriate. Receipts from the lessee for

services provided such insurance and maintenance are taken to income in the period they are earned.

Costs not recovered from the lessee, including depreciation incurred in earning the rental income are charged to income in the period in which they are incurred. However, initial direct costs can both be deferred and allocated to income over the lease term in proportion to the recognition of rental income or written off in the period in which they are incurred.

Lastly, under operating lease, a manufacturer or dealer does not recognise any selling into an operating lease because, it is not the equipment of a sale.

FOOTNOTES

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CHAPTER THREE: RESEARCH METHODOLOGY

3.1 METHOD OF DATA COLLECTION

NAL Merchant Bank Plc is chosen as the subject of study. as such the inputs into this research work are collected principally through two main sources namely:

1. Primary sources
2. Secondary sources

The primary sources are as follows:

A. Context analysis method

B. Interview method

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The Context analysis method

The context analysis method involves an analysis of documented records of transactions. designed by the bank. These records are kept in documentary section of the bank's library. and some are in form of audio and video cassettes and in series of documented files. Reports. comments and responses of different departments are usually documented. This allows the author to collect first hand information required.

paper presentations by different personalities on equipment lease – financing at seminars, contributed to our gathering of information.

3.2 METHOS OF DATA ANAYSIS

The data collected are arranged, measured and calculated in such a way as to show the conduct of NAL Merchant Bank Plc in lease financing in Nigeria. The trend analysis of data collected will be employed in order to show the commitment of the bank that led to an increase of amount expended under leasing portfolio.

3.3 SUMMARY OF RESEARCH FINDINGS

The growth of equipment lease – financing in the country is influenced by the effective performance of Merchant Banks in providing medium and long - term finances to a large number of industries in the country. To this effect, the research has a number of facts to reveal on leasing portfolio.

1. NAL Merchant Bank is the leading bank in equipment lease financing, since the bank provides over 50% of the total leased assets in the country.

2. Manufacturing industries are the dominant lessee's among various sectors of the economy because they accounted for over 50% of the total leased assets.

3. That Merchant Banks are the dominant lessors in Nigeria. because Merchant Banks finances about 97% of the total leased assets.

CHAPTER FOUR: DATA ANALYSIS AND PRESENTATION

4.1 EQUIPMENT LEASE FINANCING AND MERCHANT BANKS IN NIGERIA.

Inspite of the fact that lease business transaction is a new development in Nigeria, it has become a significant and strategic tool employed by business organisations and individuals to acquire assets. This can be tied to the tight economic measures, created by the Federal Government. These uncongenial measures affect financial position of such businesses. Therefore, they logically decided for lease arrangement option, as an alternative form of financing.

The growth of equipment lease financing has also been influenced by the increase in number of lessors in the country, who are mostly Merchant Banks. The number of lessors increased from 22 in 1988 to 40 in 1998. Out of this figure, Merchant Banks account for over 30. Table 4.1 below gives the net book value of leased assets as well as a percentage of Merchant Bank finances to total leased assets.

Table 4.1: Equipment Lease Financing and Merchant Banks in Nigeria.

Years	Net Book – value of Leased Assets =N=	Assets financed by Merchant Banks =N=	% of Merchant Banks finances to total leased asset
1997	3,532,574,736	3,417,120,000	97
1998	3,974,146,578	3,844,260,000	97

Source: 1997 and 1998 Annual Report and Accounts of Equipment Leasing Association of Nigeria (ELAN).

Despite credit ceiling policy of the Federal Government and lack of professional experts who will oversee the activities of both lessors and lessees. Merchant Banks show to be dorminant lessors both in number and amount expended for lease transactions.

4.2. NAL MERCHANT BANK AND EQUIPMENT LEASE FINANCING

Nigeria Enterprises Promotion Act of 1997 postulates that "Merchant Banks should engaged in all schedule of leasing in Nigeria". This schedule involves all different sectors of the economy. The decree

specifies a minimum lease amount, lease rates or collateral's needed under the lease agreement.

As a result of this decree, like all other Merchant Banks, NLA Merchant started leasing business in 1969 though at skeletal level. It however started in full swing leasing contract in 1977 and subsequently, the value tremendously in 1995. The table below shows leases transaction of NAL Merchant Bank from 1993 to 1998.

Table: 4.2: Lease Transaction of NAL Merchant Bank Plc

Years	Total Assets ('000) =N=	Value of equipment On lease ('000) =N=	Net book value of leased Asset as a % to loan portfolio =N=
1993	500.296	123,382	24.66%
1994	491.570	114,891	23.37%
1995	3,299,908	109,430	3.31%
1996	1,112,628	266,964	23.99%
1997	1,590,718	611,894	38.46%
1998	1,732,697	516,130	29.78%

Source: Documented Records on Leasing obtained from NAL Merchant Bank Plc.

The tremendous growth of lease transaction of the bank especially in 1997 is associated with its commitments to business in providing capital resources across various sectors of the economy through leasing arrangements.

4.3 PRICING OF EQUIPMENT

Pricing of equipment under lease arrangement affect the revenue derived by the lessor. As such the bank evaluates some fundamental factors in order to minimise risk associated with lease transaction, that could be a hitch in terms of expected revenue. These factors are as follows:

1. Evaluate the risk involved, particularly when no other support in form of collateral is provided.
2. The general return on the asset being financial.
3. The lessee's ability to expend the full rentals and thus defer tax.
4. The additional management needed to book a lease.
5. Delays in commissioning plant after the bank has disbursed funds.

Given the above, then yield percentage that the lessor will earn is determined by the length of period of the lease – contract term.

4.3.1 Repayment Period

Repayment period is the periodical payment made to the lessor by the lessee after the lease contract is signed. However, the maximum

repayment period allowable by lessors will vary among lessors, though generally it is determined by the total value of assets leased. The bank has the following guidelines for repayment period.

Maximum Repayment Period of the Bank

Total Asset Value =N=	Maximum Repayment Period Months
5,000 – 10,000	24
10,000 – 15,000	30
over 15,000	36

Source: Documented Records obtained from NAL Merchant Bank Plc.

However, on expensive leased equipment, like Aircraft, heavy agricultural equipment and medical laboratory equipment have their maximum repayment subjected to negotiations bearing the following factors:

1. The cost of the purchased equipment
2. The time and condition of delivery of the equipment in a case where the equipment has to be imported.
3. The time which the equipment is to be installed.

4.3.2 Pre – Purchase Inspection

The bank fundamentally engaged in an inspection of equipment to be purchased under lease contract. This is conducted through

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specialised engineers who are employed for the job. This is done in order to ensure that the equipment has the following features.

1. ***Durability:*** The equipment should be durable for the services expected to perform during its life span.
2. ***Multiple Use:*** This is important to the bank when it comes to disposing the asset after the contract termination especially if the lessee is no more interested to renew the contract or has a desire of outright purchase of the equipment.
3. ***Ease of Inspection:*** Equipment that is easily inspected can be diagnosed easily. As such in case of breakdown of the equipment, the problem can easily be identified. This factor is worth considered especially if the lessor will take the burden of repairs.
4. ***Simple technical operations***: Difficult operating equipment often causes disruption of production process and in the long run, this will reflect cash flow of the industry which subsequently may adversely affects the rental payments.
5. ***Availability of servicing facilities and spare parts***: Available servicing facilities and spare parts facilities continuity in production, as such revenue expectations are met and therefore, periodical rental payments to lessors are up dated.

4.4 LEASE – FINANCING OPERATIONS IN NIGERIA.

Though leasing business is new in Nigeria, however gained ground among industries. Their major lessors are Merchant Banks. As an active participant in lease operation. NAL Merchant Bank successfully increased its leasing portfolio from N266.9 million in 1996 to N611.8 million in 1997.

This remarkable increase in leasing portfolio is due response of the lessors to the increasing demands of lease transaction, which become attractive among Nigerian industries. This growth in leasing can be shown in the table below:

Total Assets on Lease in Nigeria

Leasing Financing Business	**1997 =N= '000**	**1998 =N= '000**
Assets acquired for lease during the year at cost:	846,338	700,545
Outstanding leased asset owned at year end at cost:	946,349	800,583
Rentals received during the year.	203,011	147,048
Net book value of leased asset as at year end:	611,894	516,130

Source: 1997 and 1998, Annual Report and Accounts of NAL Merchant Bank Plc.

NAL Merchant Bank being among the dominant lessor, plays a big role in providing finance to support the acquisition of above assets in the country. This is manifested in the table below:

Total Business of Leasing in Nigeria.

Leasing Business	Leasing Portfolio of NAL Merchant Bank	Percentage of lease to total growth of leasing
Assets for lease (1997)	105.740.000	34.35%
Assets acquired for lease (1998)	120.900.000	29.12%
Outstanding leased assets (1997)	390.370.000	49.41%
Outstanding leased assets (1998)	400.260.000	33.84%
Net book value of asset (1997)	250.800.000	20.90%
Net book value of asset (1998)	270.000.000	27.48%
Rentals received (1997)	45.950.000	35.03%
Rentals received (1998)	54.900.000	18.73%

Source: 1997/1998 Annual Report and Accounts of Equipment Leasing Association of Nigeria (ELAN)

4.4.1 Lease – Financing in Relation to different Sectors of the Economy

In general terms. Merchant Banks finances asset acquisition through negotiation with bank's client who is in need of the equipment. These clients will find the seller of the equipment who can either be a vendor

of a manufacturer. Logically who can these total corporate clients are classified below in respect of their type of industries.

Application of Leasing to Different Sectors of the Economy

Total Assets on lease at original Cost (year End)	**1997 =N=**	**1998 =N=**
Manufacturing	115,473,428	292,327,569
Transport	21,586,720	53,597,000
Agricultural/Quarry	2,851,850	53,126,210
Distributive	2,000,000	2,395,000
Services	7,605,193	5,612,000
Industrial Construction	48,021,412	55,051,132
Others	3,739,794	5,000,000

Sources: Economic and Financial Review (Quarterly) – Annual Report and Accounts of Central Bank of Nigeria.

From the above table, we can see an increase of total assets on lease by 99% as at year's end (1997 and 1998).

Equipment lease financing is a non- conventional way of raising funds to assets. however its attractiveness spread among our Nigerian industries. To this end. NAL Merchant Bank has a number of clients who transacts lease business. Service (transportation) industry is however. the biggest client of the bank. as such over 50% of the bank's leasing portfolio for 1997 and 1998 is committed to finance service industry. The table below shows the breakdown of total leased asset in respect of different industries financed by the bank.

Lease Transaction of NAL Merchant Bank

Total Assets on lease at original cost	1997 =N=	1998 =N=
Manufacturing Industry	338,535,200	280,218,000
Transport/Service Industry	423,169,000	350,272,500
Industrial Construction	84,633,800	70,054,500

Documents obtained from NAL Merchant Bank Plc.

Inspite of the fact that, the bank's biggest client is the Transport/Service industry, the bank discriminate among the transport industry. Preference is given to big and well established industries for the obvious reason based on the fact that, the giant companies have a high sales volume of their products and by implication, therefore very prompt in paying their installment rents.

4.4.2 Equipment Lease Financing in Nigeria and the law

Equipment lease financing is one of the specialised functions of Merchant Banks, as such they transact business with various types of lessors inform of providing funds for purchase and installation of equipment. In return they receive periodic payments by the end user of the assets.

Therefore, the two major parties involved in the lease transaction are the lessors and lessees whose contractual relationship is determined by the agreement drawn up by the parties. To engage in a contract, the parties must observe legal obligations that prevails in the country. Speaking generally, lease portfolio should not be more than 15% of total assets of a bank. This credit ceiling applied to all banks. Other legal implications pertaining to lease transactions are examined in the following areas:

A. Validity of Equipment on Lease

The bank normally evaluate equipment to be financed, in order to ensure that the equipment is not going to be used in violation of the law of the land, and if it contravene such laws, then it will not enter the transaction with such lessee.

B. Capacity of parties involved

In Nigeria, law permits Merchant Banks to operate lease financing under contractual agreement with lessee, who could be individual or corporate bodies.

In case of contracting with corporate bodies, whose contract capacity is normally stated in the articles and memorandum of the corporation

NAL Merchant Bank. therefore calls for these documents before entering any form of contract with a lessee. This is for the bank to ensure that. the articles and memorandum of the corporation expressly stated has the power to take equipment on lease and that this agreement does not violate any provision of law or of its own memorandum and articles of the corporation. And that all necessary licences. permits and permissions for the use of the equipment had been obtained.

If the lease transaction involves an individual lessee. there are no much legal implications. except that the lessor must ensure that the equipment to be financed is valid in the eyes of the law i.e. its purchases or uses doesn't contravene the rule of the law of the country.

C. Risks of Penalty Clauses

The contractual agreement of lease transaction will determine installment rents to be paid to the lessor by the lessee. In the event of the lessee's default of such payment. the lessor is bound to an estimate of such losses. However. NAL Merchant Bank does not

experience such default during the period of study; only possible delays of payments were experienced.

D. Equipment on Lease

The possession of equipment on lease is vested on the lessee while ownership lies on the lessor. Due to this possession, there is a high probability and indeed very easy for the lessee to sell to third party the lease asset.

To protect such happenings, the bank ensures that the contractual agreement must contain and signed "not sale, assign or mortgage" the leased equipment by the lessee. Additionally, a sale of leased asset to a third party does not pass a good title to such who may be an innocent purchaser.

E. Bankruptcy of the lessee

In the event of winding up of a business due to bankruptcy with or without the consent of the lessor, the lessee who is in the possession of leased asset, prior to the liquidation of the business, should rest the property to the true owner (Trustee).

F. Inspection and Sale of Equipment on lease.

Under the lease contractual agreement the bank creates a provision which stated that. The Bank has the right to inspect leased assets vested on lessees when the bank feels the need to do that." through affected lessee will be informed in advance.

On the event of expiration of lease term. the lessor (the bank) may at its discretion appoint the lessee to act as its agent to sell the equipment at negotiated price.

4.5 EVALUATION OF LOAN SYNDICATION UNIT OF NAL MERCHANT BANK

Loan syndication is a recent technique that banks use to provide finances in order to acquire capital resources by lessee. Here, two or more lessors are involved and make available funds to a lessee for purchase of desired asset, which is normally expensive.

Generally speaking therefore. the advantaged of this unit could involve the following facts:

1. Loan syndication attempts to spread risk across to the number of lessors: and this is to avoid putting much loan on a single lessor.

2. Loan syndication formula provides an opportunity to lessees who will acquire an asset no matte how expensive the asset may be. This is so because any amounts could be raised by the co – lessors.

Under this agreement, cost of equipment is evaluated, name of the lessee with its or his address is clearly stated. The name of lessor involved in a particular transaction with their respective fund provided are also stated. Sales agreement between lessee and the syndicate lessors must be signed and all invoices of each equipment purchased with authorisation letter from Inland Revenue (for tax purpose) on the transaction must be obtained.

NORTEX NIGERIA LIMITED is one of the beneficiaries under loan syndication formula of NAL Merchant Bank Plc and the following is the status report of the detail transaction of the business.

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1.	Cost of equipment	=	N40,000,000
2.	Lessee	=	Nortex Nigeria Limited
	Address	=	Kakuri Industrial Layout Abdulkadir Road, Kaduna.
3.	Lessors:	=	Amount (=N=)
	NAL Merchant Bank Plc		20,000,000
	Union Bank		20,000,000
	Total		**40,000,000**

Source: Context obtained from NAL Merchant Bank Plc.

The syndication leased weaving machines required for the expansion of the company's weaving capacity.

The syndication has sixteen quarterly rental installments, which will expire in March 2000. The lease rentals are paid in arrears.

Despite the fact that loan syndication techniques is a device by which lessees can acquire an expensive capital resources, it has its own draw backs which include the following:

1. Discussion among the co-lessors is very necessary; and this will include experts in different fields. e.g. Engineers, financial experts, lawyers, etc. as such decisions are very difficult to be reached.
2. Since it must involve not only a number of lessors, but also they have to agree on the amount of funds each lessor will make available, therefore takes longer time.

KASHIM IBRAHIM LIBRARY

4.6 CONDUCTING PHYSICAL INSPECTION OF LEASED EQUIPMENT BY THE BANK

Due to contractual nature of lease – financing of equipment that allows the lessee to be in a possession of the asset during the leas period. the lessor remains the owner. The lessor conducts a provision of inspection of the leased asset. Several reasons are responsible for that which is as follows:

1. There is a need to tag all equipment leased to customers. Appropriate wording should be made on the property of the bank followed by the bank's address. The purpose of doing this is to emphasis the fact that ownership of the assets in question is vested on the bank and at the same time making it easier for inspection team to identify the property during inspection.
2. To ensure that the equipment on lease are in good condition and their performance is as expected to the eyes of the lessee.
3. To undertake repairs, services and replacements in a situation where the lease agreements warrant the lessor to do that.

For effective inspection exercise. a number of proposals were advanced by the bank and these are:

A. Since inspection is time consuming, team leaders should therefore ensure that. that officer assigned from the team must be one who is thoroughly conversant with the company. This understanding will implore efficiency of the exercise at less time.

B. Solicitation for full cooperation of the lessee should be made in order to conduct a hitch free inspection exercise.

C. The lessee must be contacted well in advance in order to avoid interruption of production process.

4. To advise or negotiate the disposal of the asset after the expiration of the lease term in case the lessee is no more interested in either to purchase or to review the lease contract.

When the inspections are carried out. the bank official that does the inspection job usually writes a call report on the condition of the equipment. The report contains recommendations on the step to take if any unsatisfactory observations are made at the time of the inspection.

4.7 FEDERAL GOVERNMENT POLICIES TOWARDS EQUIPMNENT LEASE FINANCING

The Federal Government of Nigeria apparently was determined to put a squeeze on credit expansion. As such the so-called "free funds" are no more available. therefore many industries opted for various alternative source of funding projects which requires huge capital outlays.

Lease financing became the available and indeed easiest alternative form of financing. This is because it requires little or no collateral securities before making funds available to a lessee.

Apart from guidelines issued by the government to lessors (mostly Merchant Banks) on the conduct of both medium and long – term loan to quite number lessees. Similar guidelines are also issued to care of small and medium scale industries/enterprises (SME). In view of that the National Economic Reconstruction Fund (NERFUND) decree No. 2 of 1989 was signed into law. with the view to observe inadequacies in the provision of medium to long term financing to small and medium scale industries enterprises. especially manufacturing and agro-allied enterprises.

In line with "NERFUND". the Central Bank of Nigeria issue a circular on the small and medium scale enterprises (SME) loan scheme. The primary objective of this scheme is to support existing enterprises to restructure and modernise their operations in maintaining their comparative advantage and to regain competitiveness and help establish a new generation of viable investments in the private sector and service industries.

It is noteworthy to say that a sum of 30 million Dollars (N200 million) has been set aside in 1989 to provide an alternative source of long term financing for SME's that are under-capitalized and generally have less collateral's by wall of Equipment Leasing.

These "SME" schemes will contribute to the development of rural areas where the industries are to be located. It will live up to its objective of being designed to be a grassroots funding mechanism. Leasing is therefore likely to move from the large industrial projects in the urban areas to grassroots small and medium scale industries in the rural areas with substantial local raw materials. These schemes will also trigger off an unprecedented boom in what may be considered as small-ticket leases and new players to meet the ever-

increasing demand for equipment leasing facilities. Lessors are also likely to be art of the game more than sophisticated lessees are those understand the art of the game more than ever before.

Export stimulation loan (ESL) is another policy embarked upon by Federal Government. so that industries can expand their production capacity to engage in export especially to non-oil sector. This programme is to increase export of commodities such as cocoa. rubber and they're by - products.

With the addition of 10% investment tax credit (ITC) currently been enjoyed by lessors of agricultural plant and machinery, both parties can work together to generate the much desired proceeds.

Our small scale farmers can now afford to lease simple farm instruments to boost their production while lessors are structuring the lease such that the rental will: fall due only in harvest seasons when cash flow is most likely generated. Lease is known for its flexibility and our farmers and exporters of non-oil products may do well to take advantage of this development.

4.7.1 Equipment Lease Financing Under Structural Adjustment Programme

The decline in the country's economy necessitated affective measures to revamp the economy. As such imposition of economic reforms under Structural Adjustment Programme (SAP) were introduced by the government.

This programme deregulated imports by abolishing completely the import licence system and established a foreign exchange market (FEM). This effectively devalued the Naira and further deregulates interest rates, promotion of non-oil exports and privatisation. No doubt, these economic changes, created cash flow squeezes that led our industries to be incapacitated in sustaining themselves. As a result, they opted for lease financing alternative. This alternative has emerged as the fastest growing financial instrument for capital expenditure on plant machinery.

A variety of factors are responsible for this new trend. Firstly, the abolition of the import licence scheme eased the equipment acquisition process considerably, because of easier accessibility to foreign exchange for the importation of plant and machinery. Secondly, the substantial depreciation in the value of the Naira has

escalated the Naira cost of imported equipment by as much as 40% relative to 1986 prices. This compelled inevitably many companies to look for Bank finances: mainly Merchant Banks and this gave leasing some boost. According to J. O. OYETAN. "Since SAP commenced. we have. therefore. witnessed several BIG TICKET".

Another important factor which appears to have contributed to the growth of leasing in the government's policy on import substitution. With the banning on importation of some selected raw materials e.g. barley and wheat. the affected industries like brewing. beverage. flour milling and textiles were therefore forced to contemplate significant capital investment. either to facilitate the conversion of existing plant and machinery or to simply enable them process local substitutes.

At this juncture. the crucial supportive role under "SAP" that Merchant Banks give need not to be overlooked. this is because they provide funds to companies that responded positively by investing substantially in new plant and machinery. Additional incentives in form of "Tax-holidays" and "Investment tax credit" should be granted to both lessors and lessees.

FOOTNOTES

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2. International Memorandum. Publication of NAL Merchant Bank Plc.
3. Annual Report and Accounts (1998) of NAL Merchant Bank Plc.
4. Central Bank of Nigeria Credit guidelines (1989), and Central Bank Bullion (1997)
5. Equipment Leasing Association of Nigeria Annual Report and Accounts 1997/1998.
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CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 SUMMARY

Leasing as a method of business finance that provides the opportunity of acquiring equipment for operational use without any substantial cash outlay. was introduced into Nigeria in the 1960s. The NAL Merchant Bank as the first of its kind in the country has been carrying out leasing transaction since the sixties (1960s).

The government has played no less important role over the years towards encouraging the development of the business. Its policy measures in areas of credit squeeze promotion of the small and medium scale enterprises. investment tax credit granted lessors on agricultural equipment. granting the commercial Banks the permission to participate in the leasing transactions among others. constitute some impetus towards the growth and development of the leasing business in the country.

The Merchant Banks dominates the business in the country: the banks handle well over ninety percent of the leasing transactions. Other lessors are the finance companies and some specialised

technical companies and some specialized technical companies in the business of equipment maintenance and services. The lessees are found in various industrial establishments: a sizeable number of them belonging to the manufacturing industries while other are in the construction. printing and services industries.

The size of the leasing transaction is comparatively small inspite of the fact that there are many merchant banks (well over 34) in the country today. The leases that are arranged range from two years to ten years in terms of their tenor. The transactions are mainly in favour of finance lease arrangement as practiced by the Merchant Banks. The capital goods that are commonly available for lease are construction equipment. computers. printing machines. motor vehicles. generators. among others.

The bank further consolidated leadership role in lease financing by increasing portfolio by 51% in the year. 1997.

5.2 CONCLUSION

Equipment lease financing is an alternative forms of financing asset acquisition through contractual agreement between lessor and lessee. This contractual relationship determines the nature and terms of the contract. However, lease financing takes many form which include operating lease, finance lease, sales and leased back and lastly leveraged lease.

Lease – financing involves transaction between the lessor and lessee. The lessors are Merchant and Commercial Banks, Development Companies, Institutional investors and Independent leasing companies.

The lessees include the manufacturing, transport and construction industries.

No doubt, Merchant Banks play a dorminant role in leasing industry, because they make funds easily available to companies who seek an alternative means to acquire capital resources, especially in this current period of Structural adjustment Programme, where introduced economic measures affect adversely the financial position of such companies.

With the establishment of Equipment Leasing Association of Nigeria (ELAN), more advantages of lease transaction came into light as such become preferred option to assist acquisition by quite a number of our industries.

Equipment lease – financing though is a recent development in business but it is an important financial tool that is contributing towards development of various sectors of the economy, by providing additional source of finance. This results to some benefits, which could be outlined as follows:

1. It ensures that funds secured are invested in procuring equipment rather than put to less productive sectors.
2. Leasing increases competition among source of finance (lessors) thus increasing the availability of funds.
3. Leasing allows the survival of industries that are in financial crisis, especially with the government incentive of allowing the lessor to enjoy capital allowance who passes it to the lessee in form of reduced rents.

4. Equipment lease financing encourages to a lesser extent spring-up of new industries and to a larger extent innovation among existing industries.

5. Lease financing techniques exposes both lessors and lessees the whole idea behind the business, that in the long run benefits the two parties and generally speaking, therefore it stimulates the economy.

Lastly, chapter one of the projects discussed among other things the concept of lease financing. Objectives are clearly stated. Chapter two discussed the evolution and growth of leasing industry, the contractual relationship of lessor and lessee, leasing techniques and adhered regulations and laws governing the entire business. Types of leases are also discussed and the conditions that warrants the termination of the contract. International Accounting Standard Number 17 provides accounting procedures for both lessor and lessee. Chapter three of the research topic examined the research methodology.

Chapter four focussed on equipment lease financing in Nigeria as such examined the local asset on lease and the percentage committed to lease portfolio to different sectors of the economy. Lease

transaction of NAL Merchant Bank Plc was also examined. especially its commitment to loan syndication unit. To create enough funds for asset acquisition under current period of Structural Adjustment Programme.

Lastly. Chapter five discussed on summary, conclusion and recommendations suggested by the author in order to improve lease-financing in the country. where various authorities could give additional incentive to both lessors and lessees.

5.3 RECOMMENDATIONS

Since equipment lease financing has become an important financial tool. some recommendations are therefore advanced under three sections:

Section I

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Regulating Authorities

Regulating authorities involves the government or its agencies that are responsible for directing or giving guidelines to factor affecting the business.

1. First and foremost. the government stipulates that lessor can only enjoy capital allowance after obtaining a certificate of

acceptance from the Inspectorate Division of Federal Ministry of Industries (under the Industrial Inspectorate Act – 1971). This should be totally abrogated. because of the delay that is associated with the bureaucracy before obtaining the certificate.

2. The Federal Government of Nigeria should create a special law relating to taxation in relation to leasing business. Such law should make a clear distinction between types of leases. Under operating lease, the lessee should be charged against the income of a period. an amount that represents rental expenses on the leased asset. While under finance lease. rentals payable should be apportioned between the finance charge that should be charged against income and capital employed.

3. The credit ceiling of 15% of the total asset of Merchant and Commercial Banks being the maximum amount to be committed to lease portfolio should be reviewed to read minimum. This is to allow the banks to grant more funds to industries.

4. The guidelines of the Central Bank of Nigeria which stipulates what percentage of the total loans and advances that should go to preferred sectors is not sufficient enough to achieve desired result. as such reviewed guidelines should include specifying the amount to be devoted to:-

a. New venture projects

b. Expansion projects

c. Working capital

5. The Federal Government in form of investment tax credit should introduce additional incentives, capital allowance and this should be designed in such a way it will benefit both the lessor and lessee.

Section II

The Lessors and Lessees:

1. The lessors should try as much as possible to transact leasing business with the end of the equipment, since the asset being financed is primarily the security.
2. The lessors should not discriminate among the lessees so that not only the giant multinationals will benefit but also the locally small-scale incorporated enterprises could also benefit.
3. Lessors should liberalize their policy of receiving advance rentals immediately the agreement of leasing is signed. This may tie down lessee's working capital.

Section III

Equipment Leasing Association of Nigeria

The Equipment Leasing Association of Nigeria was established in order to protect the interest of the members of the association as well as to create lessors as well as lessees on lease financing. In view of that I wish to make the following recommendations:

1. The association should establish a cordial relationship between itself and the public and government. through making relevant information available on leasing business that the government may require considering in making appropriate laws.
2. The association should also try to analyse information and give vital statistics to all the members and the public through print outs. publications. periodical journals and pamphlets.
3. To open branches in all the 21 states of the federation who will be responsible ton organise seminar at local levels, so that the public will become more enlightened on the lease finance business.

FOOTNOTES

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2. Equipment Leasing Association of Nigeria Publication Vol. 3 No. 2 March 1998.

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