THE ROLE OF MERCHANT BANKS IN EQUIPMENT LEASING IN NIGERIA.

BY

ELEGBERUN M. MICHAEL

A Project Submitted to the Post-Graduate School, Ahmadu Bello University, Zaria in Partial Fulfilment for the Requirements for the Degree of Master of Business Administration (M.B.A.).

Department of Business Administration
Amadu Bello University
Zaria.

November, 1988.

CERTIFICATION

This project entitle THE ROLE OF MERCHANT BANKS IN EQUIPMENT LEASING IN NIGERIA by ELEGBERUN, Michael has been read and approved as having met the requirements of the Department of Business Administration, Ahmadu Bello University, Zaria, for the award of the degree of Master of Business Administration (MBA) and is therefore approved for its contribution to knowledge and literary presentation.

SUPERVISOR	DATE
EXTERNAL EXAMINER	8/1/89 DATE
HEAD OF DEPARTMENT	8/2/89 DATE
DEAN OF POSTGRADUATE SCHOOL	26/6/89 DATE

DECLARATION

I hereby declare that the work done in this MBA project is wholly my effort. No any other project of this nature or similar work has been done before in anywhere for any other degree before this research was conducted. All materials used from other sources have been duely referenced.

Sign:.....

Elegberun M. Michael

November, 1988.

DEDICATION

To My Parents
MR & MRS. ELEGBERUN
Who both made me
realized, early in life,
the value of education.

ACKNOWLEDGEMENT

Glory be to God Almighty for giving me the health and the will in making this work a success.

The success of a study of this kind requires the effort of a lot of people.

First, my thanks goes to all the staff of the Equipment Leasing Association of Nigeria (ELAN) Secretarial Victoria Island Lagos, who gave me all the necessary materials used for this study. My special thanks however goes to the President of the Equipment Leasing Association of Nigeria, Chief Dele Orishabiyi of Continental Merchant Bank Lagos, who took time off his job to answer my questions and further advised me on my choice of topic and scope for this study.

I am greateful to my supervisor Mr. Amedu who was always ready to listen and help each time I called on him either in his office or his house for assistance and advice. His personal interest and assistance in this study is inestimable.

The ELEGBERUNS also deserve special mention. They all contributed in one way or the other in making this study in particular and the MBA programme a huge success - they are my source of inspiration.

My sincere thanks also goes to Mr and Mrs. Oyebiwonnu who both gave me moral and financial support throughout the period of my MBA course.

My classmates and Friends in the MBA class Mr. Thompson Sunday and Mr. Steven O. Nwabuko deserve my thanks. Throughout the programme that we lived and study together we encouraged, assisted and re-assured one another to come out successfully.

Last but not the least is Mr. Musa Ibrahim who carefully typed this work with expertise.

While I am willing to share the success of this study with all the above mentioned people who contributed directly or indirectly to the presentation of "The role of Merchant Banks in Equipment Leasing in Nigeria." I am equally willing to share all blames and errors or short comings of this study with them.

ABSTRACT

Merchant Banks differ from Commercial Banks in that they have as their primary objective filling the medium term to long-term loan vacuum in the country. They are the specialists in the Nigerian financial system as selective cases are referred to them. Their wholesale nature and corporate focuse can have more direct impact on industries.

Equipment leasing is a unique function performed by Merchant banks in Nigeria this is because commercial banks are not allowed to engage in equipment leasing. Other financial and commercial houses that engaged in equipment leasing operate in a totally different environment and as such do not compete directly with Merchant banks, they also lack the strong financial base that would allow such competition.

While the term "Lease" may be familiar, its meaning in the context of Equipment Leasing is not fully understood. Today leasing has become familiar as a method of financing the acquisition of capital plant and equipment. Leasing is gaining prominence as the creative financing alternative for the acquisition of heavy capital goods as a result of far-reaching

economic reforms under the Structural Adjustment Programme (SAP), introduced two years ago.

Eventhough the regulatory body (CBN) has stated that a maximum of 15 per cent of the total asset of merchant banks should be devoted to equipment leasing, most of them are yet to perform up to 50 per cent of this amount. This is inspite of the current upsurge in the demand for leasing products. The performance of Merchant Banks in equipment leasing still leaves a lot to be desired.

A lease is a contractual agreement by which the lessor (owner rentor) grant rights to the lessee (tenant) to use real or personal property (asset) for a specific period of time less than its (actual) working life in return for compensation in the form of specified periodic cash payments rents. The practice of equipment leasing attracted other aspects of finance such as legal, taxation, accounting, insurance, lease or purchase etc.

While the history of Merchant banks in Nigeria is a recent occurance, authors are diversified and incoherent as to the true origin of leasing. In Nigeria the first recorded leasing activity occured

during the early 1980s. By 1972 Benworth finance limited (now BFN) and NAL Securities Limited (now NAL Merchant Bank) offered a limited amount of leasing. To promote and protect the interest of lessors - Merchant banks - in particular and the leasing industry in general the Equipment Leasing Association of Nigeria (ELAN) was formed on June 29, 1983 by six Nigerian Merchant Banks. The association has grown to about 17 members now with significant impact in the industry to show for its existence.

Equipment Leasing has continued to be a popular means of financing business operations in recent times. This is due, among other things, to the numerous advantages it has over its disadvantages and other means of financing. Despite the advantages the leasing industry in Nigeria is plagued with a lot of problems. Such as: Lack of a Leasing Law, Lack of precise regulation regarding uniform taxation; and accounting policies on leasing plans/assets, Lack of competition in the industry, lack of adequate funding; credit policy problem, the erratic and frequent changes in the fiscal/monetary policies of the Government leading to unattractive exchange rates.

Others are: Death of trained and experienced relevant financial engineers and lack of viable projects.

If the above mentioned problems can be effectively tackled, there is no doubt that the operators of the industry will be adequately equipped to face the challenges ahead in the industry. The future of leasing in Nigeria is very bright and promising.

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CHAPTER ONE

INTRODUCTION

1.1. BACKGROUND OF STUDY:

The development of Merchant Banks in Nigeria is a recent occurence. Merchant banks, commercial banks, development banks, saving-type institutions, investment companies, federal ministry of finance and the Central Bank constitute the Nigerian Financial system. The Central Bank is the regulatory body of this system. These financial intermediaries as they are also known are expected to serve as the motive force in the mobilisation and channelling of the country's financial resources into their most productive uses.

Commercial Banks are known for their ordinary banking business of accepting deposits from the general public and advancing same in the form of loans, given and charging interest respectively. Development banks like Nigerian Industrial Development Bank (NIDB), the Nigerian Bank for Commerce and Industry (NBCI) and the Nigerian Agricultural and Co-operative Bank (NACB) are created by government and private individuals with the aim of providing long-term capital for development. They differ from the commercial and

Merchant Banks in the sense that their primary concern is development and not profit making.

The Merchant banks on their part have the primary objective of filling the medium term to long-term loan vacuum in the country. They are to the financial system what the specialist hospitals are to the medical sector as selective cases are referred to the Merchant banks. Merchant banks unlike commercial banks, lend long and big; as such they employ all sorts of specialists so as to avert the risk of losing huge sum of money. Since the amount involved is usually so large that no sufficient cover can be given in the form of collateral security, the banks depend on the project for security and as such all care are taken so that the project is properly evaluated. Hence Clay and Wheble (1976)[1], wrote that "Merchant Banks" world is a complicated one of long-term lending and monitoring of long-terms trends in the economy, its various sectors and prospects of its corporate units. There has been arguments as to whether banks in Nigeria fall into the above category due to shortage of

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1. CLAY AND WHEBLE (1976): Modern Merchant Banking: Cambridge: Wood-faukner Limited P.8

capital, and counter- arguments from the banks that not only do they fall into the said category but that shortage of capital on their part cannot explain the country's lack of industrialisation.

Schatz (1964)[2], contends that there are very few applicants with acceptable projects and that despite effort to sustain them a large proportion of the acceptable projects still fall like a pack of cards. He wrote:

> .....these facts combine to indicate that the significant shortage in the indigenous sector of the Nigeria economy is one of commercially viable projects. The large false demand for capital creates the illusion that there is shortage of capital. But the record indicate that the true situation is the converse of capital shortage. Instead of a large numbers of viable projects vainly seeking capital, the situation has been one of capital vainly seeking viable projects.

Whether the above statement made some twenty-four years back can be used to explain the lack of industrialisation in this country will be examined in this study.

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2. SCHATZ S.P. (1964): Development Lending in Nigeria: Oxford University Press.

Of the many institutions involved in providing capital to industries, the Merchant banks wholesale nature and corporate focus can have a more direct impact on industries. The functions performed by these institutions can be broadly classified into banking and corporate finance. The banking services offered include management and syndication of loans, handling letters of credit, funds transfers and foreign exchange services, providing bills discounting, bills for collection, dealing in deposits, commercial papers, bankers acceptance and other money market instruments. The corporate finance functions include the provision of investment advice on real estate, agricultural, industrial and related projects; leasing machinery and equipment; management of issues of debt and equity securities; advice of joint ventures, margers and acquisitions; export financing and financial strategy.

Of all the functions of merchant banks enumerated above the unique function of equipment leasing has being enmarked for this study. Leasing is a distinct form of finance which provides specific benefits for the parties concerned. While the term "lease" may be

familiar, its meaning in the context of equipment leasing is sometimes not fully understood. In recent years leasing has become familiar as a method of financing the acquisition of capital plant and equipment. The increasing cost of bringing in new equipment into Nigeria is currently leading to an upsurge in the demand for the leasing products. Leasing is gaining prominence as the easy way out - the creative financing alternative for the acquisition of heavy capital goods.[3]

The severe decline in the country's oil revenue necessitated a complete revamping of the economic system through the imposition of far-reaching economic reforms under the structural adjustment programme (SAP), introduced two years ago. This programme deregulated imports by completely abolishing the inefficient and bureaucratic import licensing procedures and established a foreign exchange market (FEM) that devalued the Naira, in pursuit of a "realistic" exchange rate. The programme (SAP) also deregulated interest rate, provided a comprehensive tariff restructuring, curtailed public sector spending

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3. DELE ORISABIYI (1988) "Let us take caution while the windfall lasts" LEASING IN NIGERIA. ELAN Newsletter. Vol.1 No.2.

promoted non-oil exports and privatisation. These fundamental changes in the economic environment created a lot of opportunities for equipment leasing activities which up till then was relatively unknown or low viewed vis-a-vis other vehicles such as term loans, revolvers and overdrafts. Today, leasing as a financing alternative has emerged as the fastest growing financial instrument for capital expenditure on plant and machinery. In effect, equipment leasing is fast becoming an integral part of the equipment acquisition process.[4]

Industries like Brewing, Beverage, Flour milling and Textiles affected by the above government policies 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.

In Nigeria today, finance lessors are primarily the Merchant banks and as such, there are no active independent leasing companies. Other financial houses and commercial lessors operate in a totally different environment and as such do not compete directly with merchant banks as they lack the strong financial base

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4. J.A. OYETAN (1988): "Equipment Leasing and the Structural Adjustment Programme" A paper presented at the 5th Anniversary of Equipment Leasing Association of Nigeria (ELAN).

that would allow such competition. However, in a few years, government policy might encourage the growth of such companies. Such companies will be in direct competition with merchant banks for lease contracts. Commercial banks are statutorily excluded from engaging in lease financing, what more, they lack the requisite knowhow to undertake the business.

1.2. STATEMENT OF PROBLEM:

The Central Bank in a bid to carve out specific roles for merchant banks in Nigeria stated in its annual monetary policy that among other things: A maximum of 15% of total assets of merchant banks shall be in equipment leasing and other corporate banking services. Between 1976 when the first equipment leasing transaction was recorded and 1983 when the Equipment leasing Association of Nigeria was formed not up to half of this amount was achieved.

This has led government officials, Business executives, and academics to criticise merchant banks that they have not started playing roles designed for them and that they have failed to mobilise more of their funds on a

long-term basis and have been over-cautions in not undertaking such lending. That is to say there is nothing currently being done, especially in the area of equipment leasing, by the merchant banks in Nigeria that cannot be done by other financial institutions, especially commercial banks, if given the statutory go-ahead.

Merchant banks on their part have countered these criticisms as a misconception of the functions expected of merchant banks and a mark of ignorance on the activity they actually carry out. They maintain that they have justified the reasons for their establishment and that their problem is not that of capital shortage or fear of undertaking long-term lending activities but that of lack of viable projects to support.

According to S.P. Schatz(1964).....to a substantial extent, Nigeria economic policy implies reliance upon indigenous business to generate long-run economic growth, however, the performance of such business leaves much to be desired.

Even though Merchant banks are responding to the growth of lease financing in the economy, many believe that what makes it attractive to lessors (banks)

is its higher yield vis-a-vis other credit instruments. That is, if the yield is not as high as other credit instruments merchant banks would not have responded to the high demand of lease financing.

As the growth in importance of leasing as a source of finance for commerce and industry becomes prominent the accounting problems inherent in the intricate financial arrangement that are submerged under most lease agreement also become apparent. The accounting problems under lease agreement go begond traditional problems. The problems centre around the determination of proper method of accounting and reporting leasing transactions especially those that involve finance leases.

Also, there is the possibility of lessees pledging the same assets to different lessors (Merchant banks) under the full-pay-out leases for debt financing.

Other problems include the numerous information required by merchant banks before leasing equipment to prospective customers dispite the remedies available to them incase of default by the lessee. On the other hand there is little or no remedy available to the lessee should the bank breach the lease agreement.

1.3. OBJECTIVE OF THE STUDY:

The objective of this study is to examine critically the role played by merchant banks in their unique function of equipment leasing in Nigeria. Specifically it examines the following objectives/issues:

1. The function of equipment leasing by merchant banks as a unique function to it and other financial institutions that may perform such function.

2. To examine the extent to which merchant banks have adequately performed their function of equipment leasing to corporate bodies in the face of problems/hindrances encountered by such corporate bodies and merchant banks.

3. To critically examine leasing as a means of financing by considering the types of leases; legal aspect of lease; tax aspect; insurance aspects and the accounting problems posed by leasing.

4. To examine a case of leasing as opposed to outright purchase of asset and to examine the advantages and disadvantages of leasing.

5. Finally, to suggest solutions where possible to some of the problems faced by both merchant banks and corporate bodies in lease financing, and to speculate on the future of leasing in Nigeria.

1.4. SCOPE AND LIMITATIONS OF STUDY:

This study is not limited to the role of a particular merchant bank in equipment leasing. It is a general analysis of the roles played by all the merchant banks fully engaged in equipment leasing in the country today. It covers the period of 1976-1988 of active leasing by financial institutions in the country. Our analysis could not be related to specific banks as we have hoped, because of data limitations. We have therefore, given a general analysis.

Limitations usually plague research works, this research has its own share of such limitations.

Time was a serious handicap to this study. Ordinarily time is the most precious asset to a student, this is moreso when it comes to an interesting and unique topic like this. The cause work had to be completed before adequate attention could be focused on this project.

Another constrain was finance. The researcher is a private student, who has to finance the research work all by himself and wellwishers. All the headoffices of merchant banks presently operating in the country are based in Lagos. Although we made a trip to Lagos not much was achieved from the banks because most of the officials of the banks visited were not ready to cooperate. Thus, reducing the necessary information and data needed for a thorough analysis of some selected banks activities in equipment leasing. Walk into the head-office of any of the merchant banks in Lagos for relevant information and data concerning their activities in equipment leasing and you hear things like "I can't do that, that is impossible, no bank will give you such specific information" or "suppose I give you that information and you sell it to another bank, ...for instance". Prepare a questionnaire, and most of the space will be left unanswered. Downcast and frustrated we have to contend ourselves with oral interviews and data, collected from the few banks that were ready to give and mostly from the Equipment Leasing Association of Nigeria head-office in Lagos.

However, we are confident that within these constraints an indept analysis was done to enlighten readers and future researchers about the myth and realities surrounding merchant banks in Nigeria in their Equipment Leasing Business.

1.5. RESEARCH METHODOLOGY:

Sample Selection:

As of now there are about 15 merchant banks in the country of which 13 are fully engaged in active equipment leasing and are full-fledged members of the Equipment Leasing Association of Nigeria (ELAN). The other 4 members of the Association are - a financial company, a development bank and 2 commercial houses. In this study we analysed the operations of the Equipment Leasing Industry concentrating on merchant banks and made specific references to individual banks only were it was necessary.

METHOD OF DATA COLLECTION:

The data used in this study was gathered through two main sources:

i) Primary sources and

ii) Secondary sources.

Primary data:

The primary sources were questionnaires and interviews. Two set of questionnaires were designed and administered for the study. One set of questionnaire was administered to the officials of some selected banks considered as "leaders" in the leasing industry. The questions asked sought to obtain information mainly on the banks policies and problems encountered in leasing equipment to corporate clients.

The other set of questionnaire was administered to some companies in Lagos, Kaduna and Kano. This sample of companies were mainly those with leased equipment from merchant banks and those that have made effort to lease equipments from merchant banks but were not granted by the banks. The questions asked were mainly for obtaining information about the companies opinions about merchant banks and the problems they (the companies) encountered with the merchant banks when they tried to lease equipment from them. The questionnaires were either filled on the spot or were collected at a later date. The data obtained were not subjected to complex statistical tools of analysis. The data was tabulated and percentages calculated. The questions asked in both set of questionnaires were open ended ones in which the possible answers were not supplied. This is to ensure that

responses are reliable and not pre-empted.

Interviews were also held with bank officials both in Lagos and Kaduna to obtain more reliable information on their operations and problems. A most valuable interview that has provided useful information to this study is that held with the current president of Equipment Leasing Association of Nigeria at Continental Merchant Bank, Chief Dele Orisabiyi.

Secondary data:

Extensive use of secondary data was also made use of by the researcher. The major source of information was the Equipment Leasing Association of Nigeria's records and library which include Annual reports (statement of account), News letters, seminar papers, unpublished lectures etc. Other sources were text books, central bank of Nigeria publications such as the Bullion, Economic and Financial Review, CBN guidelines to Banks. Business Journals, Periodicals, Merchant banks publications, Magazines and Newspapers, and Nigerian banking annuals.

CHAPTER TWO

THEORETICAL FRAMEWORK:

2.1. THE CONCEPT OF MERCHANT BANKING:

Over the years the concept of Merchant Banking has defied a generally accepted definition. All attempts to define a merchant bank have succeeded only, in further pointing to the difficulty of a definition. This problem was illustrated by Reid (1963)[1], said he, "the term merchant bank is sometimes applied to banks who are not merchants, sometimes merchant who are not banks and sometimes to houses who are neither merchants nor banks."

Clay and Wheble (1976)[2] also wrote "it is indeed difficult to find a clear definition in the existing literature.....partly because the business of a merchant bank as if through a kladeiscope is constantly changing and is not susceptible to any definition.

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1. Edward Reid: "The role of merchant banks today". A Presidential address to the Institute of Bankers, May, 1983.

2. CLAY AND WHEBLE (1976): Modern Merchant Banking Cambridge: Woodhead Faukner Limited.

Hanson D.G. (1976)[3], in his book "service banking" referred to merchant banking as service banking to distinguish it from the traditional banking functions of commercial banks of accepting deposits, advancing loans and providing money transfer services.

Section 41(1) of the banking Act of 1969 (as amended) define a "Bank" as any person who carries on banking business and includes a commercial bank, an acceptance house, discount house and financial institution".

While section 41(1)(a) defines commercial bank" as any person who transact business in Nigeria and whose business includes the acceptance of deposits withdrawable by cheque". It then gave a long meaning of the business of banking as:

> .....the business of receiving monies from outside sources as deposits irrespective of the payment of interest or the granting of money loans and acceptance credit or the purchase and sale of securities for account of others or the incurring of the obligation to acquire in respect of loans prior to their maturity or the assumption of gurantees and other wanrrantees for others or the effecting of transfers as the commissioner may, on the recommendation of the central bank, by order published in the federal gazette designated as banking business.

This rather long meaning of banking business does not include equipment leasing at all even though

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3. HANSON, D.G. (1976) Service Banking Institute of Bankers London P. 162.

merchant banks perform most of the functions enumerated in the section. On the other hand, "Merchant Bank" is defined by section 41(1)(e) as "any person in Nigeria who is engaged in wholesale banking, medium and long term financing, equipment leasing, debt factoring, investment management, issue and acceptance of bills and the management of unit trusts". In this connection, the conclusion that could be drawn from the combined effect of section 41(1) (a) and (e) of the banking Act of 1969 is that commercial banks are statutorily precluded from entering into equipment leases. Does this help solve the myth surrounding Merchant Banking?

The limitation here is that many other institutions who are not merchant banks also engage in these activities. Perhaps, some characteristic traits usually identified with a merchant bank could help us out. These are:-

1. A high percentage of decision makers in its staff.
2. Quick decision making process.
3. High density of information.
4. Close contact with its environment.
5. Concentrates on medium and long-term engagements.
6. Dependence on fee and commission income.
7. Innovative as against repetitive operations.

8. High liquidity ratio.
9. Sophisticated service both national and international and
10. A substantial size of both human and financial resources.

Although a definition of a merchant bank is difficult to give, we shall attempt a definition which may not be comprehensive enough just like many others, it is intended to be a working definition for this piece of research. A merchant bank is a wholesale financial institution licensed under the Banking Act (1969) as ammended in 1979 as a merchant bank with a minimum paid up capital of ₦8 million that accept deposits mainly from corporate clients of not less than ₦50,000; and is expected to concentrate on medium and long-term engagements in selected productive sectors of the Nigerian economy in a professionally sophisticated manner.

2.2. THE CONCEPT OF LEASING:

The advanced Oxford Learners Dictionary of current English described a lease as "a contract or agreement by which one person, the lessor agrees to allow another the lessee to use land or building for a certain period of time usually in return for a money

payment called rent".

From the above definition, one may be tempted to conclude that leasing in a sense is restricted to land and buildings but events in recent years have proved in business world at large that the philosophy of leasing has extended to other categories of fixed assets.

Like most topics in finance, the term "lease" or "leasing" has attracted numerous definitions which focus on the legal, accounting,insurance, taxation, economic and marketing aspects of leasing transactions.

A lease by definition is a contractual agreement by which the lessor (owner rentor) grant rights to the lessee (tenant) to use real or personal property (asset) for a specific period of time less than its (actual) working life in return for compensation, usually in the form of specified periodic cash payments (rents). As a contractual agreement, the terms of the lease are framed to reflect the desires of the lesser and the lessee.

In corporate finance long-term rentals are common. A rental agreement that extend for a year or more and involves a series of fixed payment may be

recognised as a lease. Firms lease as an alternative to buying capital equipment. Every lease involves two parties. The user of the asset called the lessee, the lessee makes periodic payments to the owner of the asset, who is called the lessor. The lease contract specifies the monthly or semiannual payments, with the first payment usually due as soon as the contract is signed. The payments are usually levelled, but their time pattern can be tailored to the user's need. When a lease is terminated, the lease asset reverts to the lesser. However the lease agreement often gives the user the option to repurchase the asset or take out a new lease.

Equipment Leasing:

From a legal viewpoint the terms lease, hiring agreement and rental agreement in relation to goods have exactly the same meaning and are mutually interchangeable. The term "equipment lease" has, however, acquired a distinctive significance in commerce as denoting an agreement for the lease of plant and machinery for business purposes for a term rather longer than the ordinary rental agreement, the lessee in general being given no power to terminate the lease

before the end of the leasing period.

The United Kingdom Equipment Leasing Association define equipment leasing as "a contract between a lessor and lessee for the hire of a specific asset selected from a manufacturer or vendor of such assets by the lessee. The lessor retains ownership of the asset. The lessee has possession and use of the assets on payment of specified rentals over a period."[4]

The above definition embodies some vital features of an equipment lease which require a brief analysis. First, it is basic in an equipment lease for lessor to retain the ownership of the specific asset or chattel which is the subject-matter of the lease. Secondly, the possessory right of such chattel is vested in the lessee with an attendant right to use the chattel during the currency of the lease. It is this seperation of ownership and use that is central to the whole concept of equipment leasing and distinguishes it from other payment-by-installment types of transaction. Thirdly, the lessee is obliged to pay specified rentals over a period of time as consideration for his possession and use of the equipments. This readily implies that

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4. See, Equipment Leasing, (2nd Revised) Equipment Leasing Association, London, 1976. P. 1-2.

the non-payment of the periodic rent by the lessee could jeopardise his right to the possession and use of the equipments.

Because of the contractual nature of a lease obligation, it must be regarded as a form of financing. It is used in place of other methods of financing to acquire the use of asset. An alternative method of financing might be to purchase the asset and finance its acquisition with debt. Both the lease payment and the payment of principal and interest on debt are fixed obligations that must be met. Inability to meet these obligations will result in financial embarrassment. Thus, lease financing and debt financing are very similar from the standpoint of analyzing the ability of the firm to service fixed obligations.[5]

In lease financing, the obligations of the lessor and the lessee are specified in the lease contract. This contract contains:-

1. The basic or primary period during which the lease is noncancellable.

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5. JAMES C. VAN HORNE: Financial Management and Policy 6th Edition Prentice/Hall International Inc., London. P. 478.

2. The timing and amounts of periodic rental payments during the basic lease period.

3. Any option to renew the lease or to purchase the asset at the end of the basic lease period. Otherwise, the lessor takes possession of the asset and it is entitled to any residual value associated with it.

4. Provision for the payment of the costs of maintenance and repairs, taxes, insurance, and other expenses. With a "net lease," the lessee pays all of these costs. Under a "maintenance lease", the lessor maintains the asset and pays the insurance.[6]

In Nigeria there are three different groups in the leasing industry. These are:-

a) The Merchant Banks;
b) The Financial Houses and
c) The Commercial Lessors.

The Merchant Banks: Equipment leasing is one of the several ways merchant banks finance industries; through the negotiation of leased equipment directly to their corporate cleints. This function is unique to merchant banks because commercial banks in Nigeria are

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6. Ibid.

not allowed to undertake equipment leasing function. Merchant banks constitute the undisputed leaders of the leasing industry. They have higher capital base and are therefore in a position to play at higher stakes. For them, equipment leasing is seen more as a way of sheltering existing funds than as a major source of revenue generation.

The Financial Houses: These have relatively smaller capital base and operate in a totally different environment. As their financing is lower their client market is wider. These finance houses do not compete directly with the merchant banks as they lack the strong financial base that would allow such competition.

The Commercial Houses: These are companies that lease back-up equipment such as vehicles, generators computers etc. Again they are not in direct competition with the other groups as they provide complete packaging i.e. lease and maintain the leased equipment, a service that none of the other groups can readily provide since they lack the know-how and facilities.

What Can Be Leased?

Any item of equipment in normal use within the business or industrial environment may be leased. In Nigeria most lessors (merchant banks) aim for a minimum of £250,000 (₦ 1 million) size transaction given the time frame and related administrative costs. Items suitable for leasing include:-

1. Telecommunications equipment, including radio telephones and telephone answering equipment.
2. Computers and related items.
3. Office equipment, including accounting machines, copying machines, and office furniture.
4. Contractor's plant.
5. Machine tools.
6. Capital equipments for oil exploration and extraction.
7. Printing presses.
8. Textile Machinery.
9. Generators.

10. Aircraft.

11. Commercial vehicles such as Business Cars, Lorries and trucks.

12. Containers.

13. Locomotives and rolling-stock.

14. Ships and boats.

15. Heavy agricultural equipment.

16. Medical and dental equipment.

17. Hotel and kitchen equipment.

18. Heavy construction equipment.

19. Water drilling rigs.

20. Cranes.

21. Quarrying and mining equipment.

22. Vending machines.

23. Commercial real estate; but this is discouraged by the tedious approval procedural requirements.

The lessees range from industrial corporations, transport companies and services businesses to all kinds of governmental bodies. The common factor is that they pay lease rentals at regular intervals in

advance-monthly, quarterly, half-yearly, and annually are common. In many cases there will be no initial deposit or front-end fee. At the end of the period of the lease contract- the "primary" term - it is possible in some countries to buy the asset outright; sometimes the lessee has the legal right to do so; in other countries it is illegal or against your financial interest to allow this whether for a nominal fee or the current market value. The value of the equipment (the asset) at the end of the primary term is known as the residual. It is vitally important for the lessee to know what his position is concerning this residual because if he is able to realise some or all of its value this has a profound effect on the cost of the transaction. It is usually possible to agree upon a further lease term known as the "secondary period", but the financial conditions of this will depend on the kind of lease that has been agreed. To constract and sign a lease constroct is usually known as "writing a lease".

2.3. TYPES OF LEASES:

Fundamentally there are two main categories of leases namely: finance lease and operating lease.

It must be mentioned that the dividing line is blurred, the legal rights of the lessor and lessee and accounting tax treatment, as well as, transfer of risks of obsolescence being the distinctive factors.

Finance Leasing:

Leases which are used for financing the purchase of an asset or procuring the exclusive right to use an asset for most of its economic life are called capital leases, finance leases, full-pay-out leases or purchase leases. These four terms are often used interchangeably. This method of financing operations has become popular in Nigeria with the merchant banks because of the advantages inherent in it which will be enumerated later in the next chapter.

Under the finance lease the lessee agrees to fixed series of financial obligations (rentals) in favour for the quiet use of the equipment spread over a period of time equal to the major portion of the useful life of the equipment. Typically, during initial term, known as the primary lease term, the contract is non cancellable by either party; i.e., the lessee is irrevocably committed to continue leasing the equipment. Furthermore, the rentals paid by the

lessee must be sufficient in total to amortize the capital outlay of the lessor and to provide for the lessor's borrowing Costs and profit margin.

Here the leasing company (Bank) will act simply as a financial institution. The lessee will specify the equipment needed, and act as the lessor's agent in the matters of ordering it, inspecting it and maintaining it. The lessor is simply interested in the equipment as his legally owned asset, to which he has recourse if the lessee fails to pay his rentals. The lessor will raise the money, accept the invoice from the supplier and pay accordingly. Usually leases may be extended, after the expiration of the primary period, by a secondary period when it is usual for the rentals to be significantly reduced.

Essentially there are four test for determining whether a lease is a finance lease as opposed to an operating lease. These are:-

1. The lease arrangement is so structured as to transfer ownership of the equipment from the lessor to the lessee by the end of the lease term.

2. The leasee has an option to purchase the equipment at a bargain price.

3. The non cancellable period of the lease is equal to 75% or more of the useful life of the equipment as estimated at the inception of the lease.

4. The present value at the begining of the lease term of the minimum lease payments equal or exceeds 90% of the fair market value of the equipment (after taking into account any related investment incentives such as capital allowance etc accruing to the lessor.[7]

A similar test is suggested by the Netherland Accounting Guidelines as follows:[8]

In reference to financial lease, it states that there will be in any case economic ownership where:

- the lessee will be entitled, during or immediately after the expiry of the period for which the lessor has commited himself, to purchase the item at a

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7. FASB - Statement of financial Accounting standards No.13 "Accounting for Leases", P.7

8. Netherlands Accounting Guidelines - Triparitite Accounting Standards Committee, 1981. P.24.

price lying substantially below its market value;

- the lessor has committed himself for a period of approximately the same duration as the economic life of the asset; or

- the lessee has committed himself for a shorter period than the economic life of the asset, but has been granted an option at a considerably lower rental for the ensuring period up to approximately the end of the economic life of the asset.

Operating Lease:

Operating leases are leases which give the lessee use of physical asset for a specified period of time but which do not transfer ownership risks to the lessee. These operating leases are treated as rentals of assets even though in substance they may not differ materially from finance leases. Operating lease encompasses all other leasing contracts, which typically are cancellable by the lessee upon given due notice, and not involving any fixed future financial or any other commitment by the lessee.

An operating lease is a contract under which the asset is not wholly amortized during the primary

period (if any) of the lease, and where the lessor does not rely on the rentals in that period for his profit, but looks for the recovery of the balance of his costs and of his profits from the sale or re-lease of the returned asset at the end of the lease. Operating lease is common for goods where technological or other changes may mean that the lessee would not wish to retain the asset for its full working life and where there exists a good second-hand market e.g. copying machine, office space, furniture, cars and computers. The leasing company relies on its expertise to remarket the asset after the primary term, a thing merchant banks in Nigeria do not and will not undertake.

The importance in distinguishing between the operating lease and the finance lease frequently extends beyond the convenience to the lessee of using the equipment for a short period without having to pay its entire capital cost. Operating leases are accounted for in different ways, in the main not being capitalised on the books of the lessee. Sometimes the lessor has good reasons for needing to lease the equipment out to more than one lessee.

Note that a finance lease is primarily a devise for permitting the acquisition of a piece of equipment without paying cash for it, while the chief purpose of an operating lease is to permit the lessee to use a piece of equipment without running the risks of ownership. Again, note that in finance lease, the lessor transfers to the lessee substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred, but rentals payable must be of size and pattern as to ensure that the lessor recovers capital costs of the equipment (including associated expense) and additionally provide a return on funds invested. On the other hand, in an operating lease, the risks of ownership (including equipment obsolescence) remain with the lessor. As such, the operating lease usually allows the lessor more scope than a finance lease for providing (and charging the lessee for) additional services such as maintenance, insurance, fuel and support staff.

Finally, it is important to realize that the distinction between an operating lease and a financial lease does not rest on the length of the contract, but on its cancellability. Fiance lease are for all

practical purpose non cancellable during the initial lease term, whereas, operating leases are not usually subject to this restriction.

Other Forms Of Leasing:

Apart from the two major categories of leases enumerated above there are other special leasing situations which are important and deserve very brief mention. They are: sale-lease back, leveraged lease and consortium lease.

Sale and Leaseback or sales aid lease:

A sale and leaseback transaction is one in which the owner of a property enters into an agreement with another party to sell the property and to simultaneously lease it back. Here there is usually a connection between the lessor and the manufacturer or vendor, whereby either the lessor himself or the vendor offers a leasing package, as an alternative form of finance, on the particular goods for whose distribution he is responsible.

In this type of lease the equipment user sells to a leasing company equipment to which it already has title, and which has a reasonable remaining

They were the "Money showers" and "Cash machine".

Leveraged lease:

These are leases which are in effect direct finance leases. Direct finance leases generally result from arrangments with lessors that are primarily engaged in financing operations such as lease finance corporations, pension funds, trusts banks and the like. Leveraged lease, allows the lessor to borrow to purchase the equipment for the lessee, although the final user bears no responsibility to the original lender. This is also called "back-to-back" leasing. The lessor provides only a proportion of the capital cost from its own funds, while the balance of the funds required to meet the purchase price of the capital investment is often provided by one or more institutional investors or finance houses (the third party).

A leveraged lease may possess all of the following characteristics:

a) It is first and foremost a direct finance lease.

b) It may involve at least three parties: a lessee, a long-term creditor and a lessor (commonly called the equity participant).

c) The financing provided by the long-term creditor is non recourse as to the general credit of the lessor. The lessor is expected to provide about 60% financing and 40% investment and this arrangement grants him some kind of leverage.

d) The lessor's net investment declines during the early years once the investment has been completed and rises during the latter years of the lease before its final elimination.

Syndicated or Consortium lease:

Syndicated leases are leases where two or more lessors decide to come together to finance assets with high capital outlay thereby sharing the risks and rewards of the lease contract among themselves. Syndicated leasing is resorted to when individual lessors feel that the capital requirement for the lease is too great to be borne alone or where a lessor specifically wish to share the risk, it is possible for two or more parties to jointly lease an asset on a joint venture basis. Many financial analyst believe that the type of syndicated lease practice in Nigeria is an approximation of leverage type of lease.

2.4. IS LEASING THE SAME AS HIRE PURCHASE?

Leasing in many countries is similar to, or the same as, hire purchase. In other countries the two concepts are very different indeed and should not be confused.

In an equipment lease, the lessee is a hirer of the leased asset who is entitled to the possession and use of the leased asset while ownership remains vested in the lessor throughout the period of the lease. This rule of possession and use, as opposed to the immediate or eventual ownership of the leased asset account for the major legal distinction between an equipment lease and hire purchase which Hicks describes as "a contract of hire paid for by instalments under which the hirer may become the owner of goods if he completes payments of the hire-purchase price."[9]

From the above definition it is clear that the ultimate objective of the hirer or bailee in such transactions is the ownership of the subject-matter of the agreement, whereas in an equipment lease the ownership of the leased asset must necesserily remain vested in the lessor if the transaction is to remain a lease.

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9. See A. Hicks, Nigeria Law of Hire-Purchase 1977 P.3

It is also important to note that an equipment lease is not a conditional sale which is a transaction under which "the purchaser agrees to buy and take possession of the goods, but is not to become the owner of them until all the instalments have been paid."

The distinction between the two is epitomised by the picturesque description of a lease and a conditional sale in Re Atlanta Time Inc.[10] Which runs thus:[11] "The court has been urged to view the transaction as if the total rent were the purchase price and the monthly rental the equivalent of instalments. Such approach to the transaction overlooks the prime, essential distinction between a lease and a conditional sale to wit:in a lease, the lessee never owns the property. In the absence of a right or option in the lessee to acquire ownership of the leased property, the transaction is one of the lease."

The reference in the above-quoted dictum to "rent" and "monthly rental" is another reminder of the significance of payment of periodic rentals by the lessee to the lessor in relation to an equipment lease. Indeed, provision for rental payments is a sine qua non

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10. 259 F. Supp. 820 (U.S.D.C. 1966)

11. Ibid. P. 827.

for the determination of the issue as to whether or not a document is an equipment lease.

In Nigeria there is a raging controversy among legal experts, financial analyst , students and the like as to whether if a lease has an option to purchase, the transaction then falls within the category of hire purchase agreement or not. I personally feel that a lease agreement does not necessarily become a hire purchase simply because the agreement contains an option for the lessee to buy the equipment at the end of the lease. The contention that if a lease agreement contains an option for the lessee to buy the equipment at the end of the lease, the transaction would be treated as a Hire purchase is only applicable in England in accordance with the provision of the English Hire purchase Act of 1965. This Act is not a statute of general application as at 1st January 1900 and is therefore not applicable to Nigeria. However, if we decide to follow the English system we can only do so on the basis of our historical heritage and membership of the commonwealth. I am of the opinion that since most of the existing merchant banks in Nigeria derive their roots from United States of America, the system there will readily appeal to them.

2.5. TAX ASPECTS OF EQUIPMENT LEASING:

It is important to note that the distinction in the tax law is not as between operating and finance leases but as to whether there is an option to acquire title to the asset. As a general rule the lessee and not the lessor in finance lease is entitled to claim capital allowances only on the cost of the asset excluding interest charge which is an allowable deduction for tax purposes. The finance charge, the maintenance and insurance costs of the equipment are expenses which are tax deductible and allowable against the profits of the lessee under section 20 of companies income Tax Act (CITA) 1979. The rational is that the lessee is treated from the substance of the transaction as the owner of the assets who also puts them into use.

Operating lease on the other hand is a lease where the lessor bears all incidental costs of maintenance and insurance apart from clearly retaining the ownership of the equipment. Where all these are clearly expressed the lessor is entitled to claim capital allowances on the equipment under section 26(1) and (3) of C.I.T.A. 1979. The provisions of paragraph 18 of the 2nd schedule of companies income Tax Act 1979 concern mostly operating leases whereby the

lessor owns the equipment and it states as follows:-

(1) "Where a company owning any asset:-

(a) has incurred capital expenditure in respect thereof for the purposes of leasing that assets for use wholly, exclusively, necessarily and reasonably for the purposes of a trade or business carried on or about to be carried on by a person and

(b) leases the asset to such a person and

(c) during the whole or part of the term of the lease, the asset is used wholly and exclusively by such person in such trade or business. The provisions of this schedule shall apply with such necessary modifications as the Board may direct as though such expenditure were incurred wholly exclusively necessarily and reasonably for the purpose of a trade or business carried on by the owner from the date when such expenditure was incurred and though the owner were using the assets for the purpose of such last mentioned trade or business in the way in which and for the period during which the asset is in fact in the first mentioned trade or business.

(2) Where a company owning an equipment has incurred capital expenditure in respect there-of for the purpose of leasing that equipment for the use wholly exclusively, necessarily and reasonably for the purpose of trade or business carried on or about to be carried on by a person, the provision of this schedule shall apply to all such leases."

The revenue office before granting the claims will scrutinize the lease agreements to determine who out of the lessor or the lessee is entitled to claim capital allowances. It will determine such things as to whether:-

(i) ownership would be transferred by the end of the lease term;

(ii) the lease contains bargain purchase option;

(iii) that the lease term is for the major part of the asset useful life.

The Revenue would grant both initial allowances in the first year of purchase of the asset or equipment and annual allowances will have to be claimed by the Taxpayer in accordance with income tax commencement rules.

The amount of capital allowances to be enjoyed in any year of assessment is restricted to 75% of the assessable profit in case of manufacturing companies and 66⅔% in case of others, except companies in agro-allied industry which are not affected by this restriction. That is, if the leased assets

are used in agro-allied company, the full capital allowances will be granted. Moreover, where the leased assets are agricultural plants and equipment, there will be an additional investment allowances of 10% of such expenditure.

The current rates applicable in respect of capital Allowances are:

	Initial allowance	Annual allowance
a) Building Expenditure	5%	10%
b) Industrial Building Expenditure	15%	10%
c) Mining Expenditure	20%	10%
d) Plant Expenditure exclusing furniture and fittings.	20%	10%
e) Furniture and fittings	15%	10%
f) Motor Vehicle Expenditure	25%	20%
g) Plantation Equipment Expenditure	20%	33⅓%
h) Housing Estate Expenditure	20%	10%
i) Ranching and Plantation Expenditure	25%	15%
j) Research & Development Expenditure	25%	12½%

For the avoidance of any doubt, trade or business is defined in section 1(1) of the schedule as a trade or business or that part of a trade or business the profits of which are assessable under the Act. The Federal Board of Inland Revenue in its decision handed down on the 5th of August, 1976 stated that a company which leased out its asset to an organisation like the university was not entitled by law to claim capital allowance on the leased asset but as concession, such allowance which had already been granted would not be disturbed, but that future grants of a similar nature would be considered on individual merit.

Capital allowance can be used as an instrument of economic policy, it can be varied to have a selective impact, that is, it can be manipulated to encourage or discourage investment in new assets rather than old ones, in assets of certain type or in certain industries, in assets located in certain areas.

Capital allowance is also a regulated alternative to depreciation of assets, that is the rate is not left to the judgement of the owner of the asset to whose advantage it is to have the cost of the asset written down as rapidly as possible. Since the tax law recognises

the deductions of expenses from income before income tax is levied, it is only fair to allow as deduction from profits, expenditure incurred on fixed assets over a period of years.

The purpose of tax incentives is twofold:

a) To encourage enterprise to invest by way of capital outlay, in order to improve the capacity and efficiency of their operations and thereby improving profits.

b) To influence capital investments to be directed towards a particular sector of the economy at any particular time, in order to improve productivity, efficiency in that sector.

Reference should also be made here to the provisions of capital gain tax as it affects the disposal of business assets. Capital gain tax was introduced in Nigeria with effect from 1st April, 1967. The rate of tax being 20% on the chargeable gain with limitation on chargeable gains which are slightly over N1,000. Capital gain accruing to a lessor on disposal of business assets are liable to capital gains tax.

A lessor may take advantage of roll-over-relief as provided for in section 32(6) of capital gains Tax Act 1967. Relief permits the lessor to defer

payment of capital gains tax on chargeable gain subject to satisfying the following conditions:

a) The sale proceeds of the old asset must be reinvested in an identical asset twelve months before or after the disposal of the old asset.

b) If the total proceed of the old asset is not reinvested as stated above, the chargeable gain attributable to the amount which has not been re-invested will become assessable as it cannot be deferred.

2.6. LEGAL ASPECT OF EQUIPMENT LEASING:

The documents embodying the terms of an equipment lease has become increasingly formalised and technical partly because of the sophisticated nature of the transaction which is intended to be made the subject matter of the equipment lease and partly because of the understandable concern of the lessor to ensure that his financial outlay on the leased asset is not lost as a result of failure or inadvertence in including certain vital contractual clauses that would safeguard his position, should the need arises for the

lessor to invoke the machinery for the enforcement of the terms of the lease. The major clauses of an equipment lease are designed to outline the terms of the legal relationship between the lessor and the lessee. It should be noted that the sum total of the legal framework in this regard is the granting of a reasonably effective legal protection to the lessor in particular.

It is clear so far that an equipment lease may be a finance lease or an operating lease, but the lessor's remedies for the lessee's default in the two kinds of leases do not differ in any material sense. The remedies available to a lessor where there has been default by the lessee are partly a product of the common law nature of an equipment lease and partly a consequence of the construction of the agreed terms of the lease in so far as they relate to default. It should therefore be made clear from the outset that the remedies available to an aggrieved lessor at common law and under the contractual terms of an equipment lease are not water-tight compartments. Rather, these remedies tend to dovetail from one type into the other in such a way that the discussion of one with the outright isolation of the other is neither wise nor reasonably feasible.

Before we consider the remedies available to a lessor it is important to first of all consider what constitutes a default since such an exercise is essentially a two-stage affair. That is there cannot be remedies without default and a consideration of the former without identifying the latter will take the spice out of the discussion.

Let us now examine some specific clauses which should normally make up the legal framework in an equipment lease.

1. Lessor's Provision of Suitable Equipment: Since the equipment is the subject-matter of the contract, the lessor is obliged to provide a suitable one to the lessee. This is perhaps the only major obligation of the lessor to the lessee. This obligation also requires the lessor to ensure the unfettered and unencumbered use of the equipment by the lessee.

Experience has shown that lessors often attempt to neutralise this basic and important obligation through the inclusion of exemption clauses which exempt the lessor's from liability in respect of "any conditions warranties or representations relating to the condition of the equipment or its merchantable quality or

suitability or fitness for the particular or any purpose for which it is or may be required whether express or implied....."

To ensure that the law does not lend itself to such unsatisfactory situation, the courts have over the years developed what is now commonly referred to as the doctrine of fundamental obligation. By this, a lessor would be required to provide an equipment which broadly satisfies the requirement of the lessee, regardless of any exemption clause. For instance, if a lessee needs a motor vehicle, the lessor is obliged to provide a mechanically propelled vehicle.[12] Similarly, if the lessee requires a motor vehicle of certain description and specification, the supply by the lessor of a vehicle which fails to meet such description or specification would constitute a breach of fundamental obligation.[13]

2. Non-Payment or Irregular payment of rents:

Puntual payment of rents by the lessee to the lessor is usually made the essence of an equipment lease. The

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12. See, e.g. Karsales (Harrow) Ltd., V. Wallis (1956) 2 All 866.

13. See, e.g. Ogwu V. Leventies Motors Ltd, (1963) N.N.L.R.115

significance of this obligation is reinforced by copious provisions which render an equipment lease automatically terminated in the event of the lessee's default in payment of any of the sums payable under the lease.

Also, equipment lease usually provide for penalty payments to be made by lessee to lessor in the event of the lessee's default on rentals. Such payments sometimes relate to accrued rents and losses which may be suffered by the lessor as a result of the default.

While the above clauses are necessary to protect lessors from lessees' default in respect to rentals they may turn out to be unenforceable, should the need arise to invoke them against lessees. This situation is brought about by the rule that the amount required to be paid by the lessee in the event of default must be a genuine pre-estimate of the loss suffered by the lessor, if it is to be recoverable.[14] Where the liability of the lessee amounts to a penalty, the clause given rise to it cannot be enforced as it would be construed by the courts to be a penalty clause.[15] To

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14. See, Dunlop Pheumatic Tyre Co. Ltd. V. New Garafe and Motor Co. Ltd., (1915) A.C. 79.

15. See, Ford Motor Co. V. Armstrong (1915) 31 T.L.R. 267 and Campbell Discount Co. Ltd. V. Bridge (1962) 1 All E.R. 385.

avoid this pitfall, what is commonly done is to employ the use of an acceleration clause", whereby upon breach the balance of outstanding rents on the leased chattels become due and payable.

3. Misuse of Leased Equipment:

A lessee is generally not liable for fair wear and fear in relation to leased equipments, but is usual for leases to impose on the lessees an obligation not only to take due care in using such equipments but also to keep them in good and serviciable repair and conditions.

Problems sometimes arise as to who should be responsible for accelerated depreciation of a leased equipment. Accelerated depreciation may be due to a lot of factors including the use of the equipment or the pressures of market forces. In IAC (leasing) Limited Vs. Humphrey, the Austrialian High Court was firmly of the view"that there was no principle of law which preclude the parties from making an enforceable agreement that the lessee, and not the owner, should run the risk of the occurence of greater depreciation than had been anticipated, whether because of use of the equipment or simply because of market forces."

"The Austrialian decision should commend itself to our courts, if only to ensure that due care is taken by lessees in the way they use equipment leased to them."

4. Disposition of Leased Equipment:

Although the ownership of leased equipment remains vested in the lessor the lessee has possession and use of the equipment. It is therefore practically possible for him to sell, assign, pledge or mortgage the leased equipment to a third party. In order to safeguard against this fraudulent possibility, the convenant is reinforced by the common law principle which preclude a person from selling that which does not belong to him. Which is aptly expressed in the Latim maxim "Nemo dat quod non habet", meaning no one can give that which he does not have. Accordingly, a sale by a lessee of a leased equipment to a third party does not pass a good title to such party, even if he is an innocent purchaser for value.

However, the lessor may well be precluded from recovering his leased equipment where its disposition was madeon the order of a court exercising its competent jurisdiction; or where the lessee is held out by the

lessor as having authority to dispose of the equipment and the third party is found to have relied on such reputed authority.

5. Annexation of Leased Equipment to Land:"

"One of the covenants in equipment leases is that which enjoins lessees to ensure that in so far as such equipments are affixed to any land or building, the equipments shall be capable of being removed without any material injury or damage to the said land, building or premises, and that all such steps shall be taken as necessary to prevent title to the equipment from passing to the owner of the said land or building or premises."

Such covenants is designed to protect the lessor from the rigours of the principle of the common law relating to real property expressed in the latin maxim, "quicquid plantatur solo cedit", which means whatever is attached to soil becomes part of it. That is any equipments which are affixed to land or buildings are regarded as part of such land or buildings.

The question is, would the above water-tight provisions be sufficient to protect the interest of the lessor against an owner or mortgagee of the real property

who had no notice of the lessor's ownership of the said equipment? Informed legal opinion believed that no degree of ingenuity in draftmanship is likely to give adequate protection to an equipment lessor, in the absence of actual or constructive notice to the third party.

It has been suggested that the guarantee to the lessor in this respect is for him to invoke regularly his right of inspection. Also, plating of the said property and due notice of interest is given by the lessor to owners or mortgagees of real property, to which their leased equipment has been affixed.

6. Premature termination of Lease:

A breach of any of the covenants in the lease by the lessee may make the lessor terminate an equipment lease before the expiration of the term fixed for it. Such termination by itself does not create problems for the lessor, once there is a breach calling for such measure. However, such termination might be prejudicial to the lessor if the lessee is, for example financially weak.

It is pertinent to note that while the average equipment lease provides for matters relating to premature termination by the lessor, the same is not true

of such termination by the lessee. What one finds, is a situation where there is no provision whatsoever dealling with lessee's termination of the lease before the expiration of its term.

7. Lessee's Bankruptcy or Liquidation:

Section 55 of the Bankruptcy Act, 1979, provides for the vesting of a bankrupt's property in a trustee, immediately upon adjudication. Such property includes those things in respect of which the bankrupt is the reputed owner. Since equipments leased to a bankrupt are in his possession "by the consent and permission of the true owner", they are clearly caught by section 41(1) (c) of the Act which defines "reputed ownership" as including all goods being at the commencement of the bankruptcy in the possession, order or disposition of the bankrupt, in his trade or business, the consent and permission of the true owner, under such circumstances that he is the reputed owner thereof". The result is that the lessor of a bankrupt lessee is placed in the awkward position of having to prove as a general creditor in the lessee's bankruptcy.

In an attempt to protect the lessor from the consequences of bankruptcy, insolvency or winding-up as

the case may be, of the lessee, every equipment lease contain provisions declaring that such leases "shall automatically and without notice be terminated".

Furthermore, section 214 of the Act declares that any disposition of a company's property after the commencement of its winding up shall be a nullity. If "company's property" in the section is construed to mean property actually owned by a company, then the position of an equipment lessor is not threatened. However, if the phase were construed to mean property in the possession of a company, the security of an equipment lessor's position is bound to be threatened.

Having looked at the possible default of lease by the lessee, let us now take a look at the possible remedies available to a lessor. Most equipment leases contains a package of remedies designed to reinforce the common law remedies available to a lessor. Such remedies include the following:-

1. Automatic and immediate termination of the lease.

2. Return of the leased equipment by the lessee to the lessor.

3. Payment of accrued rents by the lessee.

4. Recovery for consequential loss suffered by the lessor.

5. Payment of anticipated rents by the lessee.

A close look at the above legal framework will reveal the fact that the obligations imposed on the lessee are by far more onerous than those imposed on the lessor. This is to be expected since the lessor, who is being divested of the possession and use of the lease equipment, naturally expects the law to provide rules that would ensure that his rights to the equipment are maintained.

2.7 INSURANCE ASPECT OF EQUIPMENT LEASING:

Lessor can be expected to attract certain liabilities in both common law and statute law as the owners of goods as outlined in the preceeding section. Whilst the main security for a lessor is the creditworthiness of the lessee, the primary function of the lessee's covenant is the payment of lease rentals, and therefore all reasonable steps should be

taken to transfer to insurance companies of substance, the risk of physical loss of, or damage to, the leased assets and the legal liabilities (which may fall upon either the lessee or the lessor) arising out of the use of those assets.

Let us now consider those areas where liability exists and the risk could be transferred to an insurance company.

1. Damage to the Property forming the basis of the Lease:

Such damage can arise at different points in time viz:

a) At manufacturers on suppliers premises.

b) In transit from manufacturer/supplier to place of use in Nigeria, including whilst temporarily warehoused during the journey.

c) During installation at premises, including testing and commissioning.

d) Whilst operating at premises i.e. after handover by the vendor/contractor.

In all these instances except D, it is probable that only little risks will be incurred, provided that the purchase, supply and instalation contracts are

with reputable companies and the bank has not agreed to accept liability for damage. Even if the bank, by the terms of the contract has accepted liability such liability can still be insured in the name of the bank with an insurance company. To obtain the widest protection, an All Risk Policy should be taken in the name of the bank.

2. General third party Liability arising out of the Existence of the Property:

The fundamental problem basic to the liability of a lessor is that only rarely does he have the opportunity to select and examine the goods he purchases and subsequently leases especially in finance lease. Third party and fire cover would be needed by banks to pick up and under insured claim or a claim where the third party sues the lessee and bank in a joint action. It is possible to extend the bank's existing public liability policy to pick up the third party liabilities.

3. Financial Loss to Lessees:

The lessee may sue the lessor (bank) for financial loss if the leased asset refused to perform its stated purpose either by volume or by standard. Insurance can be arranged for the bank but only on a specific lease basis and provided that the bank has not waived its

subrogation rights against the supplier or manufacturer.

4. Third Party liability for Products Produced by the Leased Asset:

The same potential liabilities and solution arise here as in (2) above. The major difficulty however, is that insurers are unlikely to wish to offer blanket products liability cover i.e. cover all assets. They would prefer to issue specific policies in respect of each lease or at best, in respect of all lease for one customer.

5. Workmen's Compensation:

Many companies do not insure their common law liability (which is unlimited) but only their workmen's compensation ordinance liability ₦1,600 for death or ₦3,200 for total disability). To protect their interests the banks should ensure that the customer has common law cover for all employees and then still arrange their own cover to pick up claims against the bank.

As Nigerian Unions get stranger and more sophisticated, there will be increase in common law claims because the potential award are higher.

6. Sales on Expiry of Lease!

The lessor would be liable if he sells equipment at the end of a lease and that equipment is found to be not of merchantable quality or fit for the purpose for which it was required. The lessor becomes the supplier of goods and will be liable for the consequences of detects in those goods, or in the instruction which accompany them unless a satisfactory waiver is obtained.

2.8. ACCOUNTING ASPECT OF EQUIPMENT LEASING:

Leasing has been a controversial issue ever since it came into prominence as a financing device. The controversies centre around the determination of the proper method of accounting and reporting leasing transactions especially the finance leases. Leasing is both an investment and a debt both having future orientation. The common characteristic of these two related transactions is the time value of money. An accountant must make a thorough analysis of the timing factor in both the cash inflows (investments) and cash outflow (debt) of the transaction before appropriate accounting method is employed.

The greatest problem the accountant faces is with the disclosure of leasing arrangements. There is presently a disagreement about what information is to be disclosed, how it should be disclosed and where it should be disclosed. While some accountants favour the recognition of assets and liabilities under a finance lease, some feel this information is adequate disclosure. Others favour non-recognition of leases in the Balance sheet but would recommend extensive footnote disclosure of relevant information pertaining to them. Yet there are some accountants who would not like to see leases reported either in the Balance sheet or as footnotes. To them, leasing should be a legitimate "off-balance sheet" financing.

There are no accounting problem as such regarding operating lease. As the periodic payments by the lessee are considered as expenses and as revenues by the lessor. This treatment is very straightforward. Any additional cost incurred in the course of lease will be expended either by the lessee or the lessor as may be specified in the lease agreement.

With finance leasing there appears to be a general agreement by accountants that certain capital or financing leases which are in essence instalment sale of property by a manufacturer or lessor-bank should be shown in the Balance sheet as assets and

liabilities. The assets and their related liabilities should be initially recorded by the lessee at an amount equal to the present value of the future rental payments excluding payments for services such as maintenance, property taxes, insurance etc. The assets should be depreciated by the lessee over their estimate useful lives rather than over their initial period of the lease. From the point of view of the lessor-bank the full cost of the property and the estimated future costs (other than interest) should be charged against the revenue of the period of sale. The difference between the revenue and the cost thus recognised represents a profit on the sale. Therefore, if a lease is reported as a sale by the lessor which is in reality a rental arrangement, income would be prematurely recorded as realized.

2.9. LEASING VS. PURCHASE OF FIXED ASSET:

At times analysis of investment proposal may reveal more attractive opportunities than can be absorbed by a company's normal financial structure in this case long term leasing should be considered instead of buying the fixed asset. There are other things other than financial structure which might make leasing more attractive. For instance the overall business

or industry or the overall economy may be so uncertain that it may not be prudent to embark on any substantial investment in fixed asset such as heavy industrial machines.

It appears however as if the primary aim of leasing is to avoid or reduce the need for tied up capital in fixed asset.

A lot of people will not recommend leasing because of its inherent cost such as insurance, maintenance and repairs as well as interest on the tied up capital, they forget that most of these expenses would still be incurred if the company buys the asset. The fundamental difference between owning and leasing is that with a lease neither the equipment leased as an asset nor the source of funds as a liability appears in the balance sheet - in Nigeria.

It should be made clear that leasing must not be used indiscriminately because it creates a continuing financial burden in various ways in contrast to owning fixed assets. The company's general policy regarding its investment in fixed assets and capital budgeting principle should normally apply to property lease for a long term as well as property that is purchased.[16]

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16. NEWMAN, WILLIAM AND LOGAN, JAMES: Strategy, policy and central management. 7th Edition, U.S.A. South-western Publishing Co., 1976.

The decision to lease or buy is neither a matter of indifference for the typical firm nor one for which any general presumption can be established or provided. Each case must be examined on its merits.

From the economic point of view the critical distinction is between what we shall call "short-term leases" and "long-term leases". A short term lease is a commitment to acquire and pay for a series of a specific capital goods for the shortest practicable interval of time. By a long term lease, we mean one in which the user has a commitment extending over more than a single period. The contract commitment itself will be assumed non-concellable over the agreed term of the lease.

The position of Cohen and Zinberg for security analysis purposes is put thus:

A large number of companies rent most of their buildings and many are now renting equipment as well. But companies borrow money and build or buy their own facilities. The "lease versus buy" controversy is one of the most tarried in modern corporation finance. Significant to security analysis is the fact that two companies may be working with the same amount of fixed assets and producing the same profits, but one company may show significant lower debt and interest charges on

its financial statements because its policy is to lease rather than buy. Earnings, and assets coverage of its outstanding senior securities therefore will appear more adequate. But is it really?"[17]

2.10. HISTORICAL BACKGROUND:

History of Merchant Banks In Nigeria:

Merchant Banking in Nigeria is a recent development. What was to became the first merchant bank started in 1960. On 14 September, 1960 Hill, Sammuel and company a United Kingdom Merchant bank registered a subsidiary firm in Nigeria as Philip Hill (Nig.) Limited. Similarly, on 25 November, 1960 John Holt Limited registered a subsidiary finance firm known as the Nigerian Acceptances Limited (NAL). These two firms were engaged in identical set of activities such as:

a) Financing of commodity exports by granting credits to the marketing Boards;

b) Acceptance of deposits from institutions;

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17. J.B. COHEN and E.D. ZINBARG: "Leases" Investment Analysis and Portfolio Management: Richard D. Irwin.

c) Provision of loans and advances;

d) Lending monies to businessmen and businesses;

e) Provision of issuing houses services".

These two firms (NAL and Philip Hill Ltd.) existed side by side until 1969 when they merged to form NAL Merchant Bank Limited - the only merchant bank then. Apart from the fact that both firms engagedin the same business, the merger became important because apparently there was not enough business for both, which rendered competition fruitless. This was made even easier by the fact that they were both of British origin.

Also, in August 1973 United Dominious Corporation (Nig.) Limited, a wholly owned subsidiary of UDT international, which in turn was a wholly owned subsidiary of United Dominion Trust Limited converted its hire purchase business into a Merchant Bank. This was as a result of the hire purchase regulation of 1968 which made the business of hire purchase very difficult. The name of the bank was later changed in 1977 to Nigeria Merchant Bank Limited.

1974 witnessed the emergence of more merchant banks. First to come were two American banks - First National Bank of Chicago Ltd., and First National City Bank of New York. In 1977 First National City

Bank of New York went into voluntary liquidation in protest against the indigenisation Decree. First National Bank of Chicago (Nig.) Limited on the other hand, changed its name in 1976 to International Merchant Bank to reflect the new ownership structure. Chase Merchant Bank (Nig.) Limited now Continental Merchant Bank and ICON Limited (Merchant Bankers) were both licensed in 1974. ICON Limited (Merchant Bankers) was born out of the reconstruction and reorganisation of ICON Securities Limited, which was at that time a wholly owned subsidiary of Nigerian Industrial Development Bank (NIDB). ICON Securities Limited was transformed into ICON Limited (Merchant Bankers) by NIDB, National Insurance Corporation (NICON) a wholly owned Federal Government Insurance Company, Morgan Guaranty Trust Company of New York and the Baring Brothers and Company Limited London.

Thus, as at January 1979 only the five Merchant Banks mentioned above were operating in the country. In 1979 there was the significant entry, for the first time, of Private Nigerian Investors in collaboration with Foreign Banking interest (Bank of Boston) into the business of Merchant banking known as the Nigerian-American Merchant Bank Limited.[18]

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18. ADEWUMI, W. 25 years of Merchant Banking in Nigeria. Lagos University Press, Akoka, 1985 P.9

The Merchant Banking Corporation limited and Indo-Nigerian Merchant Bank limited; were both granted licence in 1981 to commence operations as merchant banks. In 1982 three new merchant banks were granted licences, they are: Merchant Bank of Africa (Nig.) limited, First City Merchant Bank Limited and ABC Merchant Bank Limited. In October, 1983 Grindlays Merchant Bank of Nigeria limited, was licenced and it commenced business in 1984. Financial Merchant Bank Limited was also licenced to carry on the business of merchant banking. The new entrants into this sub-sector of the financial system commence business this year (1988), they are Crown Merchant Bank limited, and Alpha Merchant Bank limited. Bringing the total Merchant Banks to 15, there are evidence to show that more merchant Banks will be licenced soon.

Between 1970 and 1983, aggregate loans and advances of Merchant banks rose from ₦1.3 million to ₦1.5 billion while their deposit liabilities grew from ₦4.4 million in 1970 to ₦1.3 billion in 1983. The reason for the eagerness to establish more merchant banks could be said to reflect "the changing structure of the economy towards increased industrialisation which requires the type of services that merchant banks

provide such as wholesale banking, medium and long-term financing, equipment leasing, debt factoring etc."[19]

Literature Review:

Due to the fact merchant banking has a recent history in Nigeria and also due to the obscurity surrounding the institution there is not much in the existing literature about merchant banking. Also, data, especially financial data is difficult to come by in Nigeria. Significant write-ups about merchant banks started emerging in 1979.

S.D. Ogundipe (1979),[20] the General Manager Nigerian Merchant Bank in his article titled "Merchant Banks and Nigeria's Economic Growth" published by the CBN in the Bullion 20th Anniversary edition made a lot of observations on the activities of merchant banks. He presented a brief history of merchant banking in Nigeria and attempted a statutory and functional definition of what a merchant bank does. He was of the opinion that as far as functions are concerned, merchant banks do not seem to be indispensable. They appear to do nothing that cannot be done by other banks, and

19. Central Bank of Nigeria: Annual Reports and Accounts for 1974, P. 41.

20. S.D. OGUNDIPE (1981): Merchant Banks and Nigeria's Economic Growth" The Bullion. CBN Publication July 1979 P. 35.

investment institutions. We do not share this view, a distinguishing characteristics is their skill especially in arranging large loans through issues of bonds placed locally and internationally, loan syndications and financing of equipment leases. He went on to discuss how the merchant banks could help in the economic growth of Nigeria by placing more emphasis on corporate financing.

G.O. Nwankwo (1981)[21] in his book "The Nigerian Financial System" wrote briefly on the activities of merchant banks in Nigeria. He first of all touched on the hurdles that the ealier merchant banks had to cross and the opportunities that opened up to brighten the prospects of merchant banking operations in the country, which the merchant banks did not hesitate to take up. The author then went further to appraise the performance of merchant banks in the country so far, and then gave the differences between commercial and merchant banks which are mainly in the areas of sources and uses of funds.

As far as Nwankwo is concerned the merchant banks have not measured up to the Federal Government guidelines. He therefore adviced them to be more dynamic in some of their areas of operations especially investment

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21. G.O. Nwankwo (1980): The Nigerian Financial System. Macmillan Publishers.

advice and management, and corporate financing such as equipment leasing. His work is no doubt a good foundation for assessing the impact of merchant banks in Nigeria.

Okigbo (1981)[22] also did a similar work on merchant banks in his book, "Nigeria's Financial System Structure and Growth". He feels that the public criticisms of Merchant Banks performance between 1970 and 1977 was due to a misconception of their functions.

The commissioner of finance in an address to the Financial Review Committee in 1976 was of a contrary view. He observed: "The Merchant banks were licensed to perform other specialized services in the area of equipment leasing, corporate financing project operations and other areas of specialization for which merchant banks are renowned so far, their performance has not justified the expectations."

M.W. Gayus (1982)[23] in his unpublished MBA project, titled "Lease Financing in Nigeria Practices, Problems and Prospects." Wrote on the activities of merchant

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22. OKIGBO, P.N.C. (1981): Nigeria's Financial System: Structure and Growth. Longman Group.

23. GAYUS W. MIJE (1982) "Lease Financing in Nigeria" Unpublished MBA Project, A.B.U. Zaria.

banks only because they are the dominant parties in equipment leasing in Nigeria. A function that is becoming increasingly important to merchant banks in Nigeria. By this an organisation acquires the use of an asset without actually tying down its limited cash. A more detailed study of merchant banking in Nigeria with particular reference to equipment leasing will be done in this study with the data gathered.

Mr. Gamalil Onosode[24] while delivering a lecture in Jos in October, 1984 revealed that even in 1969 when the banking Decree was promulgated, the government did not seem to fully appreciate what role merchant banks would play in the economy, as the decree did not in any place use the expression "Merchant Bank". This more or less implied that there was no proper legal framework existing at the time for the establishment and operation of fullfledged merchant banks. However, this apparent lapse did not stop the granting of licence to Nigerian Acceptances Limited later that same year, to operate as NAL Merchant Bank.

Thus, the obscurity of the role of merchant banks in Nigeria could be said to have arisen from their recent history and the fact that their functions are not

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24. ONOSODE, G.O. (1971) "Merchant Banks and discount Houses" 8th Annual Banking Seminar of the Institute of Bankers.

publicised, at least like those of the commercial banks; this is due to their wholesale functions. The import oriented Nigerian economy of the 1970s fueled by the oil boom brought a rapid growth of merchant banks between 1974 and 1975.

Dogara (1984)[25] in his unpublished MBA project is of the view that merchant banks can develop an effective discount market where depositors can sell their certificates of deposits when in need of liquid funds without having to withdraw. This in his opinion will create medium-term funds for the merchant banks. When this is combined with loan syndications, the merchant bank can meet any kind of request from their clients, be it huge amounts or of long-term. This will take care of the merchant banks excuse that they cannot lend long because their sources of funds are of volatile nature.

Dr. Wole Adewumi (1985), recently wrote an elaborate book on merchant banking titled "25 years of merchant banking in Nigeria." The author traced the history of merchant banks in Nigeria, their functions

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25. DOGARA GADO NUNU: "The Role of Merchant Banks in Financing Industries in Nigeria." Unpublished MBA Project. A.B.U. Zaria, 1984.

and their role so far in the economic growth of the country.

The year 1976 was a watershed in the history of merchant banking in Nigeria. The pervading feeling was that Merchant banks were not performing the proper roles expected of them. In fact their porfolio of financial assets was not sufficient to show the difference between them and commercial banks. For instance according to Central Bank of Nigeria (CBN) reports, in May 1976, total loans and advances by merchant banks amounted to ₦92 million of this, ₦64.6 million (70.2 per cent) were short term advances due in a year or less. Term lending maturity between one year and three years accounted for ₦12.6 million (13.7 per cent) while loans for longer than three years accounted for just ₦14.8 million (or 16.1 per cent).

So far, some people are of the view that merchant banks in Nigeria have been under-utilised if not wrongly utilised. This opinion became loudest when in 1976 merchant banks were barred from foreign exchange transactions. Although this ban was later lifted, it was a significant comment on the official conception of what merchant banks should or should not do.

It was probably for these reasons and more that the Federal Military Government decided for the first time in 1976 to include merchant banks in its credit guidelines scheme which was before then drawn up for commercial banks alone.

Merchant banks are defined as banks because they accept deposits and owned liquid assets. The classical differences between commercial and merchant banks are atleast two. While commercial banks maintain a large number of small units of deposits held by individuals, clubs, social organisations and companies, the merchant banks maintain only a few accounts with large deposits held by corporate bodies. This in other words means that while commercial banks act as retail bankers, merchant banks provide tailor-made, fit-to-wear wholesale banking services.

Another distinguishing factor between the two is that commercial banks have the ability to create credit while this is not feasible with merchant banks who are supposed to keep most of their assets in liquid form. Merchant banks, therefore, scout the the financial market in search of money which they will buy and lend out.

Merchant banks are also involved in other numerous functions such as project finance, financial counselling and funds management. Equipment leasing is another important function performed by merchant banks. This service is becoming more popular in Nigeria where most firms are strapped of capital to invest in huge equipment outlay. Relief come to such firms through equipment leasing, a system where by a firm uses a piece of equipment like it were its own while paying a little rent on it.

Leasing financing may be used to finance a variety of activities. Ideally start-up ventures, such as paper pulp mills, beer brewery, commercial and motor assembly plants, refineries, integrated textile manufacturing plants, etc.

Merchant banks as the only operators in the sub-sector of equipment leasing is the main focus of this study. The need for such prominence assumed importance in the face of the accusation that merchant banks have performed far below expectation in this sub-sector. For instance, a maximum of 15 per cent of their total asset should be in equipment leasing but

not half of this was achieved in the years under review (1976-87).

History of Leasing:

Authors are diversified and incoherent as to the true origin of leasing. While historians would have us believe that the first leasing agreement was a transaction involving plough oxen in ancient mesopotania some 5,000 years ago. Records indicate that leasing as a means of financing business operations may have existed as early as the fifth century B.C. and that it was common during the Grecian and Roman periods. At that time as it is today assets used in business may be acquired by outright purchase or by renting under a lease contract. Many believe that capital equipment without capital (Leasing) - has been in practice since pre-medival times.

According to Tom Clark, there is some evidence that the sumerians, before 2000 B.C., used a form of operating leasing for agricultural implements and hand tools. Records also reveal that detailed regulations which distinguished between finance leasing and operating leasing, were first drawn up in Roman times- at which time also the chartering of vessels was an important commercial activities. Leasing is also credited

with a large measure of contribution towards the industrial revolution of U.S.A., as inferred from the diaries of George Washington which made references to leasing item such as mills, wagon trains etc.

The 19th century practically witnessed the metamorphosis of equipment leasing as a virile commercial activity. The earliest documented transaction in this regard relates to the leasing of railway wagons in U.K. in the 1840s, and the incorporation of the world's first registered leasing company. The Birmingham wagon company - on March 20, 1855. By early twentieth century, leasing of specialized type of equipment - plants and machinery, railway wagons, telephones, aircraft etc - became wide spread technique of financing capital goods in U.K. and U.S.A. This was further boosted during the last two world wars when equipment lease financing vitually constituted the major means of financing equipment over the life of cost-plus government contracts.

In Nigeria, it is agreed that the concept of land leasing - the earliest form of documented leased transaction in the country - was one of the legacies of our colonial past. Records available in some of the older land registries in the erstwhile major cities of

Southern protectorates, Lagos and Calabar, especially, show that leasing and sub leasing of land thrived as early as in the 1910s.

Modern Development:

The history of modern leasing would seem to date back to the early 1950's when in the United States contractors discovered the tax advantages of medium and long term equipment financing. It may however be surprising to learn that it was just as recently as May 1952 that Henry Schoenfeld set up the first modern leasing company in U.S.A. now known as United States Leasing International Inc. with its expansion into Canada and U.K. in 1959 and 1960 respectively, it catalysed the dramatic expansion in leasing business in the developed countries of Europe, Japan and Australia. By 1970, Leasing has been established in Brazil, Venezuela, Korea, Hong Kong, Singapore and other developing countries.

In Nigeria the first recorded leasing activity occured during the early 1960s when some British leasing companies wrote cross-border leases for their subsidiaries operating in the country. These leases ceased with the imposition of stringent exchange control measures at the beginning of the civil war. By 1972, Benworth Finance Limited (now BFN) and NAL Securities

Limited (now NAL Merchant Bank) offered a limited amount of leasing.

2.11. EQUIPMENT LEASING ASSOCIATION OF NIGERIA (ELAN)

During the 1970s five Merchant banks were granted operating licences bringing to six the number of Merchant Banks operating in Nigeria,

As these six merchant banks expanded their leasing activities the need arose for a formal forum to discuss ideas and current development in the leasing industry. In response to this, the Equipment Leasing Association of Nigeria developed out of a series of informal meetings among representatives of six merchant banks. The first of such meetings was held at Bacchus Resturant on the 23rd April, 1982.

On June 29, 1983, six Nigerian Merchant banks formed the Equipment Leasing Association of Nigeria (ELAN). The Association was established to promote and protect the interests of members of the Association in exercise of their business as equipment lessors.

The founding members of the Association are:-

1. Continental Merchant Bank Nigeria Limited.

2. ICON Limited (Merchant Bankers).
3. International Merchant Bank (Nigeria) Limited.
4. NAL Merchant Bank Limited.
5. Nigerian - American Merchant Bank Limited.
6. Nigeria Merchant Bank Limited.

The Association has continued to expand as more members have been admitted bringing the number of members to seventeen. Other members of the Association are:-

7. A.B.C. Merchant Bank Limited.
8. Benworth Finance Nigeria Limited.
9. First City Merchant Bank Limited.
10. Financial Merchant Bank Limited.
11. Grindlays Merchant Bank Limited.
12. Holt Leasing.
13. Indo-Nigerian Merchant Bank Limited.
14. Leventis Technical Limited.
15. Merchant Bank of Africa Limited.
16. Merchant Banking Corporation and
17. Nigerian Bank for Commerce and Industry.

Aside from protecting the interest of its members and regulating the conduct of the leasing business, the next most important objective of the

Equipment Leasing Association of Nigeria (ELAN) is increasing awareness and expertise of lessees and potential lessees and operators respectively. This objective the Association strives to achieve through the organisation of seminars - both technical and non-technical and workshops, and the publication of a quarterly journal. The Association has had successful seminars and workshops in the past. As part of its continuing publicity and education programme, the association successfully hosted a non-fee paying seminar on the 2nd of April, 1986. The aim of the seminar was to educate the financial community in general and lessees in particular on certain concepts on leasing activities.

The quickening pace of change, increased membership and competition in the industry mandates an effective education and information programme that can ensure healthy competition and orderly development of the young industry. In collaboration with the internationally reputed firm of lease educational consultants - Amembal & Isom (A & I) Utah USA, the association organised the first quantitative hands-on workshop at the Lagos Sheraton in February 1987 that attracted full participation. The workshop was an overwhelming success as it effectively raised the knowledge platform of the

practice of leasing in the market. In response to the tremendous feedback, the association again successfully organised a two-tier A & I /ELAN workshop between February 22 - 26th 1988 incorporating an advanced level programme.

As part of the Association primary function of gathering and disseminating information on leasing, it began in 1987 the following projects:

1. A newsletter titled "LEASING IN NIGERIA" that on a quarterly basis provides the market with an update on analysis of developments in the industry.

2. A Leasing Reference Book that provides members with an all inclusive guide to available leasing services in the market, the equivalent of a leasing "Yellow pages".

3. An Annual Survey of Leasing Business, a publication that documents the Association's effort at collating operational information on leasing business conducted by members on a yearly basis.

4. A leasing textbook, that will fill the existing gap in local educational literature on leasing business.

ELAN's major pre-occupation now is to put pressure on Government to promulgate a decree to codify the law of Equipment Leasing in the country. To this end the association has set up a committee to prepare a draft of such laws and practice of leasing requiring legislation. It has also employed the services of a solicitor to prepare a legislation on equipment leasing.

In recognition of the role ELAN plays in Nigeria's leasing market, it was nominated by the Nigerian Accounting Standards Board into a steering committee on Accounting for leases which was set up to prepare an exposure draft on Accounting for leases. The exposure draft is a preliminary working paper which serves as a basis for formulating an accounting standard.

Other objectives of the association include:

1. Acting as an organ of communication for and to represent members of the association in all or any of their relationships with government departments local and other public authorities, trade associations, and any other bodies organisations, and to offer facilities for confering with and making known the views of members of the association in regard to actual or proposed legislation or any other matters directly or indirectly affecting business interests.

2. To establish and maintain good relationship between members of the association and the public generally and to publish and make known information on matters relating to the business carried on by equipment lessors both for the protection of the public and for the protection of the members of the association.

3. To promote honourable practice in the conduct of their business by members of the association.

4. To disseminate information, data and statistics among members of the association and to print, publish, issue and circulate papers, periodicals, books, circulars and other literary matters and to promote and organise meetings, conferences, lectures and other activities such as may seem to the association conducive to the attainment of any of its objectives.

5. To affiliate with and procure the affiliation of financial and kindred institutions and bodies within the Federal Republic of Nigeria or elsewhere.

6. To do all such things as are incidental or conducive to the attainment of the above objectives or any of them.

Although ELAN is yet to be formally recognised by the government, it has tacitly given the association acceptance by officially inviting two of its members to the constitution drafting committee.

Mainwhile, as the association continues to entertain various enquiries from students, reporters and the public in general on matters affecting leasing in Nigeria the need arose for a permanent secretariat to enhance the operational efficiency of the association. The association has therefore established a permanent secretariat at 1 Engineering close, Engineering House, Victoria Island Lagos. The Secretariat presently houses a library that contains the most recent information on leasing activities within Nigeria and worldwide.

CHAPTER THREE

PRESENTATION AND ANALYSIS OF DATA:

3.1. EQUIPMENT LEASING IN THE NIGERIAN ECONOMY:

In 1979 Nigeria had a net surplus of export over imports to the tune of ₦1.8 billion, rising to ₦2.4 billion in 1980. By 1981 this had turned into a deficit of ₦2.9 billion due to excessive importation, indiscriminate massive borrowing from unsuitable external finance source, having failed to be prudent mindful of the heavy costs and future debt servicing problems. In April 1982 the President of the country came up with a stabilisation Act which was to:

a) reduce the level of import and conserve scarce foreign exchange;

b) encourage and protect local industries and

c) ensure strict adherence to government priorities.

In 1986 the stabilisation Act was replaced by the Structural Adjustment Programme (SAP). This programme among other things:

(i) Abolish the import licencing practice by the government, thus streamlining the inefficient bureaucracy that surrounded the process of equipment importation.

(ii) Introduces a foreign exchange market which devalues the Naira, thereby raising the cost of procuring equipment.

(iii) Placed strict restrictions on bank lending as part of an overall government deflationary policy.

(iv) Placed a ban on selected raw materials that can be substituted locally mainly maize, wheat, barley and malt.

This programme (SAP) which aimed at rationalising the economy became compelling on the government as a result of severe decline in oil revenue. The present economic difficulty has created new demand and developments for the equipment leasing industry. These developments brought new flexibilities in procuring lease equipment and marketing new products. The focal rationale for leasing which hinges on the

thrust that it is the use of an equipment not its ownership was driven home in the austere environment. The industry also made innovative strides in reaction to the new business challenges. Lease syndication, corporate acquisition using lease funding, aviation leasing exemplifying the industry's ability to meet the challenging needs of the Nigerian business community.[1]

There were also major changes within the industry that mirror developments in the new environment. There were new players in the leasing business, primarily from new merchant banks, non-bank finance companies, leasing subsidiaries of development banks and there are prospects that, in line with the existing pace of deregulation commercial banks will soon begin leasing business. Increased competition and deregulation of interest rates have resulted in narrowing margins, in a period when the credit worthiness of lessees have been eroded by soft markets and high FEM operating cost. From the foregoing it is therefore clear that the growth of the Leasing industry has occured against the background of the most fundamental changes in the Nigerian economy.

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1. Equipment Leasing Association of Nigeria's Annual Report 1986/87.

TABLE 3.1

MERCHANT BANKS INVESTMENTS 1966 - 1983 (₦'M)

No.	Item	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
1.	Treasury Bills .	-	-	0.5	0.42	0.2	-	2.3	1.0	8.7	11.9	7.4	26.9	7.8	46.9	40.6	51.1	1717	5145
2.	Treasury Certificates	-	-	-	-	2.0	2.9	4.1	6.9	3.3	1.5	7.0	4.8	6.3	13.5	18.0	18.3	3.0	11.0
3.	Call Money Fund	-	-	-	-	-	-	-	1.7	-	-	-	-	-	-	-	-	-	-
	Total Liquid Assets	-	-	0.5	0.42	2.2	2.9	6.4	9.6	12.0	13.4	14.4	31.7	14.1	60.4	58.6	59.4	1747	3855
4.	Bankers Unit Funds	-	-	-	-	-	-	-	-	-	13.1	31.6	11.8	0.2	9.0	-	-	-	-
5.	Stabli-sation Securities	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
6.	Certificates of Deposits	-	-	-	-	-	-	-	-	-	-	9.3	-	11.0	10.5	6.2	10.0	1397	1557
7.	Equipment on Lease	-	-	-	-	-	-	-	-	-	-	3.2	12.5	13.4	15.5	18.0	14.6	26.8	48.9
8.	Others	4	4	0.04	0.4	0.4	0.6	0.14	-	4.1	4.8	4.6	6.6	0.5	0.5	1.5	1.6	2.1	9.7
	TOTAL INVESTMENTS	4	4	0.54	0.46	2.6	3.5	6.6	9.6	16.1	18.2	44.6	82.3	50.7	81.	93.3	95.6	3433	5998
	TOTAL LIQUID ASSETS % OF TOTAL INVESTMENTS	-	-	91 9582	81 .23	82 .92	97 .66	99 .89	74 .9	73 .87	37 .45	39 .39	27 .52	69 .81	62 .34	62 .40	50 .13	74 .8	64 .3

As can be seen from table 5.1. active equipment leasing by merchant banks started in 1976, as the first attempts at leasing in the early 70s. were confused with the concept of hire purchase. Prior to late 1985 equipment leasing is relatively unknown in the country. More regular means of funding business ventures such as term loans and advances are better known. With the advent of SFEM and the subsequent depreciation of the Naira, the price of productive machinery and equipment escalated beyond the reach of most enterpreneurs in the country. It became difficult for investors to acquire equipment under the traditional and very familiar funding arrangements. Partly accountable for this as well is the requirement for collaterals for the more familiar funding vehicles. And of course the fact that lessees and users of these assets are allowed to write off all lease rentals to their profit and loss accounts making leasing attractive. This situation which is still very much with us explain the current apparent mushrooming of leasing activities.

The leasing industry has come a long way. In 1983 when ELAN was founded total leasing volume was estimated at N61 million and there were only 6 member companies.

(See table 3.2 below). Statistics made available by

TABLE 3.2.

MERCHANT BANKS' EQUIPMENT ON LEASE IN NIGERIA: AT NET BOOK VALUE IN ₦' MILLION.

	1980	1981	1982	1983	1984	TOTAL
CHASE	6.5	6.8	13.3	18.9	21.3	66.8
ICON	-	12.4	16.3	14.0	18.3	61.00
IMB	-	-	7.9	8.4	10.6	26.9
NAL	-	-	6.8	6.8	7.2	20.8
NMB	1.7	1.8	6.3	11.8	13.5	35.1
NAMB	-	-	0.9	1.9	2.3	5.1
TOTAL:	8.2	21.0	51.5	61.8	73.2	215.7

ELAN show that in 1985, the assets acquired for lease stood at about ₦61.9 million. There is not much difference between the figures of 1983 and 1985. But 1985 was the year of increased awearness among, the business community about leasing as an alternative for the acquisition of assets. 1985 was the year Mr. Nwobu Arize an official of the International Corporation (IFC),

an affiliate body of the World Bank with a number of business interests in Nigeria indicated its intention on setting up an equipment leasing company in Nigeria. He said:

> The equipment leasing association of Nigeria has initiated that a representative of the IFC visited the country on a fact finding tour where officials of the Central Bank of Nigeria, Merchant Banks and Commercial Banks discussed leasing/the capital market in general. Experts have however, opined that instead of leasing codes as drawn for instance, by UNIDROIT, an international body for drafting leasing codes, it would be more beneficial for Nigeria to draft one that puts into consideration her economic peculiarities.2

/and

The 1985 figure registered 50% growth to ₦92.5 million in 1986, the year SAP was introduced (see table 3.3 overleaf). In 1987 total Assets acquired for lease increased three fold to approximately ₦400 million. This figure works out at an average of ₦22.4 million lease asset per member during the year. Judging from the clues in the market place, it may not be too ambitious. This indicates a significant growth in Leasing activities amongst ELAN members. This trend is expected to be sustained in the years ahead, in view of the stimulus provided by the ramifications of SAP.

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2. NWOBU Arize: "IFC keen to establish leasing firm in Nigeria". Business times. Monday, March 18th, 1985.

TABLE 3.3

BREAKDOWN OF ASSETS ACQUIRED BY ELAN MEMBERS AS AT 31ST DECEMBER, 1987

Assets Acquired:	1982	1983	1984	1985	1986	1987
For Lease at Cost	23,712,000	16,142,430	45,820,000	61,583,620	92,462,352	349,268,352
Total Assets Owned on lease (as at year end at original cost)	60,918,000	75,237,630	100,283,000	159,434,043	206,708,164	3,349,710,785
Net Book value of leased Asset as at year end	36,199,000	42,878,679	63,895,000	73,140,197	123,161,419	
Net Book value of leased Assets as a % of loan Portfolio	4.94%	5.03%	6.30%	8.23%	8.49%	
Rentals Received	13,068,000	17,550,000	23,500,000	30,888,971	32,358,927	7m7,958,659

SOURCE: ELAN SECRETARIAT.

It also implies that equipment leasing has now been embraced as a practical technique for financing capital goods in Nigeria needed to modernize, diversify, and or enhance production activities or services.

The projections are that within the forseeable future, equipment leasing will continue to enjoy substantial growth notwithstanding an overall weak economic climate, with a low level of new investment, continuing unemployment problems, and internal and external deficits.

Looking at the breakdown of assets acquired by members, it is observed that the acquisition of plant and machinery tops the table, and has also increased tremendously when compared to the 1986 figure of ₦9m and 1988 projection. Ships and aircrafts during the year 1987 also received much attention, as table 3.4 indicates a rise in their acquisition.

The preference given to these two mentioned items I believe is due to the fact that they are each essential players in Nigerian business today, and therefore the demand will continue to be high especially in Nigeria's present economic predicament where the purchase of capital equipment is vitually impossible by a single person.

It should be mentioned at this point that the acquisition of particular types of equipment especially plant and machinery could have adverse effects such as obsolescence and improved technology, and therefore careful analysis must be done before purchase.

TABLE 3.4

ELAN LEASING STATISTICS AS AT 31ST DECEMBER, 1987

	1987	1986
Plant and Machinery	200,043,410	9,017,399
Computer & Office Equipment	2,271,080	1,672,082
Ships & Aircrafts	66,121,458	25,605,180
Production Equipment	27,295,786	8,703,413
Cars	34,179,203	6,041,898
Medicals	1,098,287	-
Lease Hold Improvements	27,512	27,265
Airconditioners	3,636,120	2,380,600

SOURCE: ELAN Secretariat.

Lease rentals quoted by ELAN members do vary considerably ranging from ₦3.54/₦100 cost of equipment to ₦11.05/₦100 cost of equipment. The average interest rates remain relatively uniform. (See table 3.5.)

The lion share of lease written in the country has always gone to the manufacturing sector. From a little over ₦35 million in 1986, it climbed to ₦178 million last year. Transport comes second with ₦11.2 million in 1986 and ₦80.7 million in 1987. No lease has been written for the public sector. Distributive trade got ₦6.8 million in 1986 and a paltry ₦66,543 in 1987, mainly on sales aid leases (see table 3.6.)

1987 was clearly a big year for leasing with the launching of new lease products and an estimated additional lease volume of over ₦200 million. It was a year of corporate acquisition in Nigeria and lease financing proved a viable tool for this activitity. Leventis Technical Limited acquired the power generating leasing business of Allied Oil Field. Nigerian Bottling Company Limited (Coca-cola) acquired Nigerian Soft Drinks Company Limited (Schweppes). Both transactions were financed by Nigerian-American Merchant Bank Limited.

TABLE 3.5

MEMBERS	BEFORE TAX %	AFTER TAX %
Financial Lessors:		
A.B.C. Merchant Bank Limited	18	
Benworth Finance Nigeria Limited	19	
Continental Merchant Bank Nig. Limited	18	
ICON Limited (Merchant Bankers)	16	
Indo-Nigerian Merchant Bank Limited	17. 5	16.5
International Merchant Bank Limited	16	
Merchant Banking Corporation	16.5-19.5	
NAL Merchant Bank Limited	17-19	18-21
Nigeria-American Merchant Bank Ltd.	17-20	10- 12
Nigeria Merchant Bank Limited	17-19	-
Operating Lessors:		
Holt Leasing	17-22.5	-

SOURCE: ELAN Secretariat.

TABLE 3.6

TOTAL ASSETS ON LEASE AT YEAR END AT ORIGINAL COST - ANALYSIS BY TYPE OF LESSEE

	1987 (₦)	1986(₦)
Manufacturing	178,614,481	35,126,890
Transport	80,731,338	11,299,058
Agriculture	8,728,300	4,000,000
Distributive	66,543	6,810,000
Service	13,893,000	7,168,081
Government	-	-
Others:		
Construction	1,779,410	-
Industrial	20,603,870	12,050,503

SOURCE: ELAN Secretariat.

Aircraft Leasing business also took off with a bang in 1987. Continental Merchant Bank Limited concluded two transactions. Kabo Air procurement of a

Boeing 747 aircraft from Eastern Airlines USA and Skypower Express Limited acquired 5 Brazilian made Embraer passenger aircrafts. International Merchant Bank also finance the acquisition of aircraft for Aero contractors and Imani Aviation and, also distribution vehicles to Seven Up Bottling Company through sale and lease back.

The first syndicated leasing transaction was also recorded in 1987 with the successful conclusion of a ₦20 million lease syndication for Spintex Nigeria Limited by Continental Merchant Bank Limited. Other syndicated leasing transaction in 1987 were primarily in the textile industry. International Merchant Bank Limited came to the market with a ₦30 million lease syndication on behalf of president industies limited expansion into spinning business. First City Merchant Bank entered the market with a ₦20 million lease syndication for ENPEE industries. Five star industries' effort at syndicating ₦25 million on a lease basis was agented by Merchant Bank of Africa Limited.

In February 1988, International Merchant Bank Limited leading a group of eight other merchant banks came

to the market with a lease of ₦36.7 million (the largest so far) for United Spinners Nigeria Limited as joint lessors. The other banks in the syndicate are:- NMB, First Interstate, Financial Merchant Bank, NBC, Nigbel, ABC, Indo-Nigerian and Abacus Merchant Banks. Two other banks have committed ₦11 million to the lease syndication, making it an over subscribed venture.

Nigerian Industrial Development Bank Limited (NIDB) became the first bank in the market to set up a fully owned subsidiary in the leasing business. The Equipment Leasing Company of Nigeria will coordinate and manage NIDB's Leasing business.

From the data presented above we can safely conclude without mincing words that the rapid growth in equipment lease finance currently experienced in Nigeria can be directly attributed to the on going Structural Adjustment Programme (SAP).

The Product:

The great majority of lease transactions in Nigeria are thinly distinguished medium to long term instalment loans. They are predominantly full-pay out

finance leases incorporating options for a secondary lease period at peppercon rentals and a purchase opportunity at the prevailing fair market value, through an unrelated third party, with a substantial rental rebate to the lessee. Security deposits are occassionally structured in lease transactions while residual exposure is seldom adopted.

Because of the scarcity of long term funding and foreign exchange, lease are written in Naira for up to five years duration. Most lessors aim for a minimum of $250,000 (₦1 million) size transaction given the time frame and related administrative costs. With the recent elimination of interest rate controls, floating rate leases are usually more common than fixed. As pointed out earlier the most popular types of equipment available for lease finance include production plant and equipment, automobiles and computers. Commercial real estate is deliberately discouraged by the banks through tedious approval procedural requirements.

Sale and lease back transactions were popular because the lessee usually obtains the hitherto

required import licences and imports the equipment in its name. Presently, lease purchase transactions are common, ensuring that the letters of credit areopened in the lessor's name thus obviating the need to get the consent of the lessee's existing Debenture charge holders: Nigerian-American Merchant Bank Limited (Bank of Boston affiliate) and Continental Merchant Bank pioneered back to back lease transactions that enable operating lessors to refinance new lease contracts.

The Market:

Apart from locally assembled automobiles that utilize imported completely knocked down kits, other items of equipment are imported. This is as a result of the absence of a local equipment manufacturing industry.

The amount of merchandise imported by Nigeria between 1983-85 and the amounts and proportions accounted for by imports of machinery and transportation are rough basis from which to determine potential leasing demand. (See table 3.7 overleaf).

TABLE 3.7

Period	Merchandise Imported during the period (US $ Million) A	as % of A	Machinery & Transportation Equipment Imported during the period. (US $ million)
1983	11,393	38	4,329
1984	8,900	38*	3,382
1985	8,400	38*	3,192

*Estimate

Source: World Bank Development Reports 1983-1986

The table shows that approximately $3 billion of Machinery and Transportation Equipment were imported into Nigeria in 1985. This when compared to the total volume of leased assets booked by Equipment Leasing Association of Nigeria in 1986 shows the vast potential that exists for leasing business. Although the value of imported equipment from the table below is declining over the period, indicative of the prevailing foreign exchange problem in Nigeria, the demand for equipment

is actually on the increase. A recent survey conducted by the Equipment Leasing Association of Nigeria on a cross section of the Nigerian business community, revealed that the present economic difficulty has created new demand for equipment.

Competition:

Competition in the leasing industry must be looked at from different angles as the word acquires a new meaning when applied to the different players in the leasing industry viz: the Merchant Banks, the Financial Houses and the Commercial Lessors. These three group of players do not compete with one another as each carry out different kind of service. Whatever competition that may exist is within each group.

Thus competition in the leasing industry is vitually non existent. This is because in each of the group demand far outstrips supply, and what competition there is among them is dampened by the wide market available. Aside from this, the leasing industry in Nigeria is still in its infancy, thus knowledge of leasing and its advantages both for the lessor and the lessee is still sparse.

This lack of competition may explain the high interest rates charged by the merchant banks on leased equipment. But even then there is a measure of competition, especially as regards the newly licensed merchant banks as their capital bases are smaller and yet they must compete in the same environment with their bigger brethren. However, it remains relatively easy for new entrants to break into the industry as the demand for lease financing far outstrips the supply of available funds and outlets. However, the most apparent reason for this lack of competition, is the consistent refusal of the Central Bank to allow Commercial Banks into the market. Should this happen the Commercial Banks with their massive capital base and wider reach in terms of customer access will provide greater competition for the rest of the players presently in the market.

Funding:

Merchant Banks derive most of the funds used to finance their lease transactions from Deposits. Most of these deposits are short term depositors fund e.g. 90 days, while an average lease could span 5 years or even

more. This creates an obvious problem as the funds available do not match the need. Another means of funding is by inter bank funding. In recent times the cost of funds has increased greatly primarily due to the Central Bank deregulation of the interest rates. However, the supposed deregulation is cosmetic and the Central Bank still maintains a minimum rediscount rate so that the cost of funds are totally governed by unfettered market forces.

The sources of funds for leasing are limited, the competition for the available funds is high, as a consequence rentals are higher than they would be in a freer market. In Nigeria there are no supplies funding for leases nor are there any method for public funding via equities, neither do we have bond funding. The effect is that it narrows the fund available for leasing thereby constraining the leasing industry. The effect of these limits is that whatever funds there are compete with funding for standard loans. Because of the economic culture in Nigeria more operators settle for term loans and overdrafts leaving very meagre funds for leasing.

Credit:

The present criteria for credibility is too rigid for a growing economy like ours. Although Equipment leasing requires no collateral, the effect of the present credit policies is that lease finance is treated the same way as other credit finance. This trend is highly restrictive to the growth of the Leasing industry. The direct result of this is that only companies with impeccable audit reports and profitable operation can obtain lease finance in today's market. This trend is not encouraging and the result is that lots of medium potential are stranded before they even have a chance.

Also there is a stunning lack of information about credit and the options open to the average business concern. This lack of information especially as it affects leasing is pitiful in that most members of the public are not even aware of equipment leasing, what the concept is, and the opportunities leasing offers as a means of obtaining credit financing. There is also the added fact that in a recessional environment like ours, credit is bound to deteriorate, and has done so greatly. Moreso the continuing decline

of the Naira vis-a-vis other currencies has added to growing confusion in credit assessment. We now have a situation where the value of equipment has risen astronomically on paper, while effective demand commensurate with the yield of such equipment remains in some cases at over fifty per cent lower than the paper value.

3.2. STRUCTURING LEASES:

The problem of structuring leases is not so much the technical difficulty, but that as has been demonstrated earlier in chapter two, it is rather complicated by the fact that leasing plan can be offered in almost intimate variety. This then means that each leasing plan so chosen is endowed with some specific structural feature(s).

But since the most distinguishing characteristic of a finance leasing plan is that it permits the lessee to avoid paying the full purchase price of a piece of equipment on the date it is acquired, it then means that the evaluation parameters for granting a finance lease facility will be similar to that governing

credits. Most times the parameters for evaluating lease finance are very stiff. Hence, the structuring of leases is usually preceeded by the evaluation of the key risks associated with a finance lease facility relationship.

Generally, the structuring of most finance leases require first of all the information for granting credits. These are:-

1. General Company Background: This will include:

a) The Certificate of incorporation (where applicable)

b) The Article of Memorandum and of Association.
c) Ownership by percentage.
d) Description of nature of business.
e) Copies of at least two years prior tax returns of owners and company - (of owners only in a start-up)

2. On-going Companies (i.e. a going concern)

a) Industry data where appropriate to determine how those already in the business are doing.
b) Market trend including effects of competition and governmental regulations.
c) Data on selling prices and costs.

d) Methods of sales/distribution of products or services.

e) Customer base and term sale.

f) Supply sources and payment term.

g) Production capacity and production lead-time.

h) Education/Professional background and business experience of key managers.

i) Cost of at least three year's financial statements.

j) Current bank lines, current borrowing and securities provided.

k) Copies of existing loan agreements and debenture, if any.

l) Amount of funds and types of facilities requested and how these funds are to be used.

m) Copies of title deeds of company's land and properties to be used as security.

n) Listing of personal tangible properties (e.g. land and buildings.)

3. Start-up Companies:

a) Market supply.

b) Total investments.

c) Equity participation.

d) Financing requirement.

e) Equipment supply sources.

f) Raw material supply sources and payment terms.

g) Proposed method of sale/distribution of products and terms of sale.

h) Capability of the proposed building contractor for the factor.

i) Suitability of location.

j) Organisation chart.

k) Agreements and contracts (if applicable).

l) Projection of Balance sheets, income statements and cash flows.

Lease Facilities:

For lease facilities, in addition to the above (i.e. 1, 2 & 3) the following are also necessary:

1. Full technical specification of the equipment. Cost of equipment, detailing base cost, shipping, insurance, installation and commissioning costs.

2. Operating costs detailing consumables, maintenance and servicing, spare parts and insurance.

3. Available spare parts and servicing facilities for equipment.

4. Estimates operating life of the equipment under normal use.

5. Lessors previous operating experience with the equipment.

6. Estimates of the number of such equipment in use in the country indicating the major users.

7. Estimation of the market value of the equipment over the primary lease period.

8. Details of third parties willing to sell the equipment on behalf of the bank should the need arise.

9. Details of major government regulations regarding the importation and use of the equipment.

The evaluation of the lessee's ability to promptly make rental payments involves mostly the thorough assessment of the financial and cashflow forecasts of the projects for which the equipment lease facility is meant for. This evaluation of the credit risk is with a view to discounting greater uncertainty about the size and variability of future cash-flows as well as voluntary disposition of the project sponsore to apply the cash-flows towards settling the rental payable as and when due.

A well structured lease results from the proper integration of 4 main groups of lease variables:

1. Lessor's risk assessment variables
2. Lessors requirement variables.
3. Lessee need variables.
4. Lease structuring variables.

Risk Assessment of Lessee:

The first step in structuring a lease is for the lessor to evaluate and then quantify the risk inherent in the lease. Risk results from the degree of credit worthiness of the lessee combined with collateral and residual value of the equipment to be leased. Also general business/industry risk affects the transaction indirectly. Once risk has been assessed, it must be converted into a structuring variable.

In general, if a lease is deemed risky by the lessor, any of the following variables might be affected:

a) Lease yield increased with all other factors except payment amount remaining constant.
b) Additional advance payment required.
c) Guaranteed residual requiredin lieu of a purchase option.
d) Security deposit required or increased.
e) Lease form shortened.
f) Personal gurantee required.
g) Additional collateral beyond the leased equipment - PLC.
h) Increased late fees for deliquent rental payments (for example, 4% if ten days late plus 12% interest).
i) All variable risk insured.

Lessor Requirements:

Once the lessor has appraised the risk and credit worthiness of the lessee and converted that into structuring variables, the lessor must look to its remaining needs and the to the requirements of the lessee. Meeting the sometimes conflicting needs of the lessor and lessee represents the more difficult part of lease structuring.

Typical lessor requirements that might be at variance with lessee needs in lease structuring are enumerated below:-

a) A yield sufficient to meet the lessor's after tax weighted cost of capital.

b) Floating or variable payment leases. Absence of fewer matching.

c) Quantification and conversion of lessee risk into lease structuring variables.

d) A net lease rather than a full service lease.

e) Residual dependence - the lessor may want the equipment purchased by the lessee to avoid resale problem. On the other hand, the lessor may want the equipment returned at the end of the lease due to its increased value.

f) Whether to structure the lease as "leveraged" or otherwise.

Lessee Requirements:

Lessee requirements would include the following items which frequently are at variance with the needs of the lessor mentioned above:

a) Few advance payments and no security deposit. We should recall that one of the primary motives for leasing is the minimising of down payments to conserve working capital.

b) A lease that permits subsequent ownership through a fixed low percentage of cost purchase option or through a residual permitting title transfer.

c) An extended lease term which directly affects the amount of each lease payment. The longer the lease term, the smaller the lease payment.

d) Sufficient lessor capacity to perform. Will the lessor be able to live up to the lease provision or will he attempt to break the lease because of poor structuring?

e) Avoidance of fair market value purchase option in lieu of fixed percentages or fixed amount purchase option.

f) Cancellation privilege early in the lease with a series of declining purchase options available during the cancellation period.

g) Fixed payment lease with variable term or variable residual guarantee in lieu of variable payment tied to prime rate. Such variable length or variable residual leases compensate the lessor for changing borrowing costs.

Given both the lessor needs and those of the lessee, the lessor must structure a lease comparable to both.

Lease Structuring Variables:

A list of lease structuring variable would take a whole book, however, the following list of 5 groups of structuring variables highlights the significant structuring considerations:

a) Advance payments.
b) Security deposits - (i) interest bearing (ii) Non-interest bearing.
c) Duration of lease.
d) Residuals.
e) Variability of lease payments to satisfy various lessee/lessor needs.

In my view a well structured finance lease is usually a logical synthesis of the risks evaluation, and the special features or characteristics of the chosen leasing plan. Therefore, before disbursing funds on any leasing transaction a typical Nigerian bank will make sure that the following documents are fully incorporated and executed:

1. Application to lease.
2. Proposal/commitment letter.
3. Master lease agreement.
4. Lease schedule.
5. Purchase/renewal option.
6. Certification of delivery and acceptance.
7. Purchase order.
8. State sales/use tax exemption certificate.
9. Tax indemnification.
10. Interim lease.
11. Corporate resolution and opinion of counsel regarding corporate authority.
12. Guaranty (optional).
13. Financing statements.
14. Insurance letter and (compensating balances).
15. Investment tax credit letter.
16. Landlord consent and waiver.
17. Conditionalities (pre-conditions)/lease covenants.

The above documents and procedures may be incorporated into a single document in one form or another. It is what is generally referred to as the Legal documentations on equipment leasing.[3]

3.3. THE ROLE OF MERCHANT BANKS IN EQUIPMENT LEASING:

The Central Bank in its annual monetary policy circulars to banks has endeavoured to distinguish merchant banks and carve out a specific roles for them. In this context, the current monetary policy circular provides that:

1. A minimum of 40% of total loans and advances shall be of medium and long-term nature with a maturity of not less than three years.
2. A maximum of 20% of loans and advances shall be of short term nature (i.e. maturing within 12 months.)
3. A maximum of 15% of total assets shall be in equipment leasing and other corporate banking services.

The Central Bank has thus given official support to the argument in financial circles that merchant banks would make a more tangible contribution to the economic development of Nigeria if they provide more specialist services such as equipment leasing and other corporate

3. M.O. SHONIBARE: Legal documentation on equipment leasing" Paper presented at a seminar held on 20th - 21st Nov.1984.

services.

However, to fulfil the role mapped out for them, merchant banks face the problem of liquidity. The source and nature of funds available to them outride their own capital and reserves are essentially short-term deposits repayable within one year. In these circumstances, it is difficult for merchant banks to concentrate on long-term lending, as the resultant effect of issuing short-term funds to finance long-term projects could be quite disastrous.

By the nature of their deposits, mostly containing demand deposits withdrawable at anytime, commercial banks can ill-afford to provide long-term capital to Nigerian industries. This role can better be done by merchant banks who have highly concentrated deposits. More than 60 per cent of which is made up of time deposit (see table 3.8. overleaf).

This is inspite of the fact that merchant bank's loans and advances are very small compared to those of commercial banks. This is more evident in table 3.9 overleaf.

TABLE 3.8

MERCHANT BANKS DEPOSITS (₦ MILLION)

	1980	1981	1982	1983	1984
CHASE	95.7	193.9	345	463.5	523.2
ICON	130.4	213	309	295.8	325.43
IMB	106.7	176	407	463.5	512.4
NAL	79.7	97	142.6	210	275.35
NMB	28	54	100	210.5	283.52
NAMB	-	71	124	161	223
TOTAL	361.2	806.6	1,428.8	1,514	2,142.9

Source: Computed from the Balance sheet of the Banks.

TABLE 3.9

BANKS LOANS AND ADVANCES IN (₦ MILLION)

	1980	1981	1982	1983	1984
Commercial Banks	6,349.1	8,582.9	10,275.5	10,612.7	11,135.2
Merchant Banks	293.8	552.8	778.8	984.6	1,223.1

Source: Computed from CBN Economic and Financial Review and the merchant bank's statements of account.

The role of merchant banks in equipment leasing is more to be seen in the provision of medium, long-term, and permanent capital. Medium and long-term financing is important to Nigeria's industrialisation more than short-term finance because it provides the base for any productive activities. It is only after the industrial base has been established that short-term finance on the provision of working capital becomes meaningful. For a sound industrial system we need not only the finance of imported machinery for the assembly of spare parts here at home, we also need long-term loans. It is highly regretable, therefore, that in these austere times, companies have turned their attention to the short-term financing of working capital particularly raw materials.

The entry of merchant banks in Nigeria into the field of equipment leasing is a significant phenomenon and will accelerate the development of this important market. For instance, most commercial and industrial companies have ready access to banks. Usually, the lessee will negotiate the purchase of the equipment according to his own specifications and then will issue a purchase order in the name of the bank. Because the lessee negotiates directly with an oversea manufacturer,

he may be able to obtain a lower price than when he gets the same equipment from a business partner who may "load" the purchase order sometimes up to 130%. Sometimes, the bank acts as a middleman between the lessee and the manufacturer in negotiating terms of purchase and means of payment. In this case the bank exercise greater care in dealing with both the manufacturer and the lessee.

Merchant banks have made it possible for many projects/disused equipments lying waste in various locations throughout the country due to lack of funds to be executed through leasing, particularly through leasing syndicates. How many banks for instance, can put down ₦20 million without advance security? They can only do that through leasing. Thus, it is apparent that equipment leasing is a growing vital source of providing additional funds to finance many businesses or trades both for survival and expansion especially during this trying period of our economy. With the syndicated leases, the burden of risks is diversified and shared among many financiers.

Merchant banks also make it possible for corporations to make use of "off-balance-sheet financing" since assets

obtained by leasing, especially in this country, are not shown on a company's balance sheet, the net profit ratio of the company is enhanced or made favourable. Furthermore, since lease obligations do not appear as a liability on the balance sheet, presumably the company stands a better chance of borrowing additional funds when the need arises and at an attractive interest rate. Thus, corporation's cash position or lines of credit with banks are marginally or not even affected.

Merchant banks through leasing offers a great deal of opportunity for both industrial and commercial organisations having no capital expenditure programmes and those whose budgets are lean to use the needed equipment or asset with a minimum of cash outlay (an effective argument of salesmen of leasing companies and bankers) Leasing is becoming more competitive with the entry of merchant banks, manufacturing organisations and independent leasing companies into the market. The effective utilization of the services provided by these leasing organisations depends on the advantages and disadvantages perceived by those who must finance their business operations either by payment of cash or by leasing.

It is important to note that even though the volume of equipment on lease by merchant banks is on the increase, they are yet to perform up to the CBN credit guidelines of 15% maximum. Prior to the formation of ELAN and the recent economic difficulty merchant banks have nothing to write home about on equipment on-lease. This is probably due to the medium to long-term maturity of leased equipments and the fear of technological obsolescence. A careful analysis of tables 3.10, 3.11 and 3.12 will show that most of the merchant banks performed less than 50 per cent of the prescribed maximum.

TABLE 3.10

TOTAL LEASED EQUIPMENT AS A PERCENTAGE OF TOTAL LOANS AND ADVANCES:

	1980	1981	1982	1983	1984
CHASE	8.125	7.234	9.852	7.311	6.625
ICON	8.696	7.251	9.131	7.071	7.771
IMB	-	6.263	3.264	3.478	3.618
NAL	-	5.665	6.182	4.755	3.651
NMB	6.071	5.806	11.25	18.154	20.769
NAMB	-	909	2.045	2.533	2.774
TOTAL	22.892	32.128	41.724	43.302	45.208

TABLE 3.11

TOTAL LEASE EQUIPMENT AS A PERCENTAGE OF TOTAL ASSETS

	1980	1981	1982	1983	AVERAGE
CHASE	.059	.031	.035	.033	.033
ICON	-	.026	.025	.026	.026
IMB	-	-	.017	.016	.016
NAL	-	-	.034	.020	.027
NMB	.048	.030	.056	.052	.047
NAMB	-	-	.004	.008	.006
AVERAGE	.054	.029	.029	.026	.026

TABLE 3.12

MERCHANT BANKS EQUIPMENT ON LEASE AS A PERCENTAGE OF TOTAL ASSETS - PRESCRIBED, ACTUAL AND DEVIATION:

YEAR	PRESCRIBED MAXIMUM	ACTUAL	DEVIATION
1976	15	1.9	13.1
1977	15	7.6	7.4
1978	15	6.9	8.1
1979	15	2.5	12.5
1980	15	1.8	13.2
1981	15	0.8	14.2
1982	15	0.8	14.2
1983	15	1.1	13.9

Source: C.B.N. Annual Report and Statement of Accounts (Various Years).

As table 3.12 shows, only during 1977 and 1978 have the banks been close to half of the 15 percent maximum prescribed by the monetary authorities. Merchant banks performance in this area is quite inconsequential. This further shows that the current upsurge in the demand for leasing product is due either, to the SAP or the activities of ELAN or both.

3.4. ADVANTAGES OF EQUIPMENT LEASE:

The essential feature of leasing is that it enables the use of capital equipment to be secured by revenue expenditure thus freeing resources for other uses. It is fundamental therefore in any evaluation of leasing to consider the question of how profitably funds may be deployed which otherwise would be locked up in the purchase of the asset. Leasing involves no charge on capital; instead, it imposes a continuing charge on income. However, there are many other advantages to leasing which, though not directly quantifiable, should not be overlooked when comparing leasing with other forms of finance.

The particular circumstances of the parties to any capital transaction will, of course, affect the evaluation of different forms of finance. Generally leasing

offers the following advantages to both lessors and lessees:

1. Lease transactions enable banks to invest their surplus funds for a return on their investment and to take advantage of the differential between lending and borrowing.

2. In many cases the total cost of the lessee is less than if the goods had been taken under a hire purchase or credit sale agreement, though this is by no means invariably the case.

3. Leasing assists forward budgeting and management discipline in several ways. The normally, fixed amount and regular nature of rental payments is helpful in the lessee's cash flow forcasting.

4. Equipment leases commonly provide that the lessee shall take the equipment for a minimum period and shall thereafter have the option either to continue the lease at a reduced rental or to return or buy the equipment. This facility can prove very useful to the lessee in the event of the equipment becoming obsolete, since he can then replace it at the end of the minimum period without having to incur liability for payment of its full value.

5. Frequently a lessee under an equipment lease, unlike a hirer under a hire purchase agreement, is not

obliged to pay an initial deposit. He may, however, be required to make at least the first rental payment in advance.

6. As the taking of machinery under an equipment lease involves a revenue expense, the lessee avoids the necessity for showing an item of capital expenditure in its balance sheet when seeking credit from its bank. This particular advantage is perhaps overrated, as a banker would have to be decidedly unsophisticated if he failed to pick up expenditure of this kind when perusing the accounts of the lessee concerned.

7. Leasing is a hedge against inflation. It provides a safety valve against inflation and ensure that the lessee continues to operate normally irrespective of interest rate fluctuations or inflation. The use of the asset involved is obtained immediately but the payment are met out of future earnings and are made in fixed money terms, with real costs falling over the years.

8. Leasing provides tax relief as rental payments are expensed before taxation. More importantly, leases offer tax savings through capital allowances and deferred taxes provided by income tax legislation.

9. Leasing enables the use of an equipment procured on revenue expenditure rather than on capital expenditure.

With proper evaluation therefore, funds which could have otherwise been tied up in the outright purchase of an equipment can be profitably deployed.

10. By leasing business organisation may use the most efficient methods of production and remain competitive in its industry because it leases new equipment before they are even thoroughly tested. Sometimes, government contracts may call for additional fixed assets which may take a long time to acquire when compared to leasing. Such emergencies are more adequately met by leasing than by buying.

11. From the lessee's investment policy stance, leasing provides a source of medium-term finance not readily available elsewhere and in addition, a flexible form of finance. It is a much freer way of negotiating financing as the leases are negotiated on tailormade terms for the lessee to match his particular needs. Thus cash flow is matched to the anticipated life of the asset; this is an element of financial stability that has sometimes been understated.

12. Certainty of availability during the lease period. A lease is a medium-term facility which cannot be withdrawn or curtailed by credit squeezes or changes in economic conditions unless the lessee defaults. This certainty of cash flow can remove the anxiety that may be associated

with facilities, such as overdrafts, repayable on demand.

13. Leasing is a maximum form of finance as it normally provides finance for the entire cost of the equipment. That is it enables the build-in of most costs, like delivery, installation, etc into the main capital outlay and amortized over the period.

14. Leasing gives an ability to financial groups to provide facilities in line with the different types of risk undertaken. The nature of leasing, which secures ownership of the asset to the lessor, is, in a sense, a half-way stage between an equity participation and a simple medium-term loan.

15. Leasing removes the need to tie up capital in fixed assets. By means of a lease, the use of an asset can be obtained without capital outlay. Assuming that the need for the asset has been established, the income generated by the use of the asset should be more than sufficient to meet the series of rentals. The commitment can be self-financing. This is particularly important when a firm is expanding fast, or when credit is tight, but it would be wrong to suppose that these are the only circumstances in which leasing is advantageous.

16. As the lessor is the owner of the asset the lessee is not burdened by special pre-import deposit requirements or ministry of industries tax acceptance procedures.

17. In situations where statutory or budget constraints prevent the acquisition of an asset, leasing often allows use of the asset.

18. Finally, capital allowances which are claimed by the lessor are normally reflected in the form of reduced rentals from the start of the lease. This reduction is particularly beneficial to those capital intensive companies whose earnings may not be sufficient to obtain immediate and full benefit from the allowances that would be available to them if an asset were purchased.

The above list is by no means exhaustive.

3.5. DISADVANTAGES OF EQUIPMENT LEASE:

From the point of view of the lessor, during period of economic boom, leasing may be profitable as there will be very few defaulters. However, during economic depression many companies may be unable to meet their obligations in their agreement resulting in mass defaulters with consequent reduction of income. The control

of second hand market will be lost by manufacturers as the market would be flooded with used equipments which nobody wants.

In a rapidly changing technology, the lessor may find it difficult to obtain payments from lessees who find their equipment suddenly obsolete.

From the lessee's point of view, the disadvantages are operational and financial. In most cases, the lessee cannot use the asset as he pleases because of certain operational restrictions imposed by the lessor. The restrictions to which the lessee is subjected when leasing may, in some cases, be more annoying than those found in debt contracts. For instance, a lessee may be required to obtain permission from the lessor before needed improvements are made to a property. If the contract is noncancelable the lessee may find himself with a rotten apple which he is helpless to change. With an owned property, the owner can do whatever he pleases with the property; he can sell it or pledge it for another debt or even write it off.

In spite of these disadvantages, leasing has continued to be popular as a means of financing business operations.

CHAPTER FOUR

4.1. CONCLUSIONS AND RECOMMENDATIONS:

We have seen Equipment Leasing play a dynamic role in Nigeria's restructuring effort and vast potentials exist for reflating the economy through leasing. The future of leasing business in 1988 and beyond promises to continue to be an exciting one. Experts believe that equipment leasing has come to stay as an attractive sources of finance. With the escalating cost of heavy equipment the future of industry lies in leasing.

Leasing has been on the cutting edge of capital investments in most of the developed world and of recent in Brazil, India and Indonesia. It has developed structures which add maximum value to capital equipment acquisition as conditions and needs have changed.

Nigerian companies require efficient equipment to survive in an era of tough realities. Profitability has been low, debt levels have been high and most lending in the market is short term variable rates. New start-up firms have certain characteristics. Little cash, limited debt lines, little or no taxable income and uncertainty

about total equipment needs. A mature company displays other characteristics. The need to keep debt lines free and comply with debt covenants while maintaining flexibility in off-setting tax liabilities with tax incentives and use of potentially technologically obsolete equipment.

All of these make purchasing equipment difficult and risky. No other method of providing capital equipment can give all the advantages of leasing enumerated in the preceding chapter.

While asset and liability management has become more sophisticated, and even more critical to business, leasing provides a flexible management tool. Leasing usually leaves the lessee with better liquidity and asset flexibility. The efficiency of leasing the asset- is measured by the risks the equipment ownership passed unto the lessor and the importance of conserving cash.

In leasing equipment, the lessor has several risk judgements to make. Among them are credit worthiness, business or industrial practices of the lessee, collateral value of the equipment - now and in future - technology, remarketing environment, tax laws and the stability of

the cast of funding. In short, the lessee gets the use of equipment and makes a periodic rental payment. The lessor assumes a credit risk, equipment risk and legal risk for an anticipated profit from managing and disposing of the asset. Thus, it is clear that leasing is a potent tool for rapid industrialisation. Therefore, if encouraged and directed or controlled towards meaningful purposes, we will see such purposes achieved perhaps faster and more efficiently than other methods of finance.[1]

The entry of merchant banks into the leasing market is a welcome phenomenon as more attractive leasing packages can be negotiated by the merchant banks through their oversea correspondent banks on behalf of Nigerian industrialists and merchants. Regrettably, the entry of merchant banks into the leasing market has had adverse effect on the operations of the independent finance companies. Many industrialists and merchants prefer to deal directly with the banks or the manufacturers rather than deal with intermediaries such as finance companies. As a result, independent finance companies are being squeezed out of the leasing market and the merchant banks are now the undisputed dominant operators of the leasing market.

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1. FOLA ADEOLU: "Equipment Leasing: A Case for Additional Tax Incentives." 1987.

Apart from the fact that the leasing industry is still at its infancy, despite its virture it is plagued with a lot of problems. These are:

1. Lack of a leasing law.
2. Lack of precise regulation regarding uniform taxation; and
3. Accounting policies on leasing plans/assets.
4. Lack of competition in the industry.
5. Lack of adequate funding.
6. Credit policy problem.
7. The erratic and frequent changes in the fiscal/ monetary policies of the federal government leading to unattractive exchange rates.
8. Death of Trained and Experienced relevant financial engineers.
9. Lack of viable projects.

Leasing Law:

At this moment in time, Nigeria has no enacted law on Equipment Leasing; leasing transactions are therefore governed mostly by the roles of common law and to some extent by company law. There are no decided Nigerian cases relating to leasing but the various decisions of the English courts. As the law in Nigeria now stands, the rules of common law and the few decided English cases are not sufficient to clarify all the

rights and protection for both parties to lease agreement.

I believe that inorder to encourage an orderly but rapid growth of the leasing industry specific law should be enacted now. One of the most important catalysts to the development of any industry is the certainty of the law relating to such industry. People are more prepared to take business risks when they know the extent to which they have rights and are protected under the law of the land.

If the industry is allowed to develop harp hazardly, there will come a time when there would be public outcry against some excesses (real or imagined) on the part of either the lessors or the lessees and with our usual tradition of "Crisis management" experts, the government would just hurridly enact a decree that would concentrate only on curbing the excesses without ensuring that the growth of the industry is not stiffled in the process of enforcing the decree.

The proposed law should be simple and concise. A lengthy and complicated law would stifle rather than encourage the growth of the industry. In drafting our law, we should look to the practice in other jurisdictions

merely for guidance rather than for the purpose of wholesale copying. The most suitable model for our own law is in my view the proposed UNIDROIT Rules on International Equipment Leasing as adopted by the UNIDROIT study group 1984 of the international institute for the unification of private law. Although the rules are primarily for International Equipment Leasing, it can easily be modified for domestic use. It is brief, it covers only the essential elements which would satisfy both parties.

The Law for Nigeria should take into account the following fundamental aspects of leasing:

a) Definition; clear and concise definition of leases including both types of leases-finance and operating leases.

b) Lessors' Rights and obligations.

c) Lessee Rights and obligations.

d) Registration of leases at the companies registry in the file of the lessee.

e) Accounting standards: The Law should provide for the treatment of leased equipment, rentals, depreciation etc in both the books of the lessor as well as the lessee.

f) Investment and Business Incentives.

g) Recognition of Equipment Leasing Association of Nigeria (ELAN): Recognising the Association would give validity to the internal regulations it would set up so as to maintain high standard within the industry.[2]

In this time of economic recession, leasing is proving to be a more acceptable means of finance for companies who are very hard hit for capital. This is the most opportune time for the Leasing Association to push forth for a leasing law for this country as we all know, legislation under the military regime is faster than under the civilians. A well drafted law would give a further boost to the fast development of the leasing industry in Nigeria.

Tax Incentives:

Equipment lessors in Nigeria claim that the allowances allowed them by the provisions of paragraph 18(1) of the second schedule to the companies Income Tax Act No. 22 of 1961 and section 26(1) and 3 of the 1979 amendment in respect of any asset on which it has incurred capital outlay and has it leased out to another person for the whole or exclusive use of the lessee's business is too small, and that an increase in this

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2. A.O. GUNMEFUN: "Equipment Leasing Law for Nigeria". Paper Presented at a seminar on Tax and Legal Issues relating to equipment Leasing. 1984.

allowances would serve as an incentive to the growth of the industry. It is my view that any changes to be made in the Tax Laws with respect to leases cannot be made in the proposed Law on Leasing. The changes have to be made with the Tax Laws itself.

In order to aid economic growth and industrial development, the Federal Government should review tax incentives available to financial institutions engaged in leasing activities by increasing the rate of capital allowances specifically for leased assets thereby allowing an early write off of the assets. Other conditions such as the location of industries making use of the leased asset may be imposed. This will encourage lessors to move out of urban areas to less developed parts of the country. The incentive will also encourage lessors to give favourable considerations to projects with longer pay back periods.

I would like to stress at this juncture that various private sector companies which have responded positively by investing substantially in new plant and machinery deserve additional incentives, possibly by way of extended "Tax Holidays". In addition, lessors who have supported this cause by jointly financing such capital expenditures should enjoy similar tax incentives to encourage them in playing their crucial "supportive role"

under SAP. It should be stressed that under SAP, the lessors are assuming more risks as reflected in the harsh competitive climate under which the lessee has to operate, the limited collateral value of the underlying asset because of prohibitive importation costs, the funding mis-match and various other market constraints. All these factors help to define the need for additional incentives for lessors.[3]

Some economic sectors which can be considered as top priority areas and for which special incentives for lessors are recommended given their potential role in the industrialisation process are:-

a) Agricultural and Agro-Allied Production.
b) Export-Oriented Production.
c) Research and development.
d) Activities needed to increase local value-added.
e) Rural industrialisation.

Recommended Incentives:

1) An investment allowance of at least 20% should be granted to the lessors financing the equipment.

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3. J.A. OYETAN: "Equipment Leasing and the Structural Adjustment Programme" Paper presented on the 5th anniversary of ELAN. 1988.

ii) A first year allowance of up to 60% should be provided on leased assets.

iii) Capital Allowance on the above should be excluded in interpreting section 36(7) of the finance (Miscellaneous Taxation Provision) Decree No.4 of 1985. In effect, for investments in these priority sectors, capital allowances on leased assets should not be affected by the restriction of a maximum of 75% of the profits for the year in the case of manufacturing companies and 66.67% in other cases imposed by that section of the Decree.

2. The provisions of the Capital Gains Tax Decree should be relaxed in order to render it less punitive. Specifically, lessors should be encouraged to invest in used assets that can be refurbished without the lessee being put in a position to pay substantial tax on imputed capital gains.

3. A legislation clarifying the tax position on joint ownership of capital assets i.e. How will the capital allowance be shared?

4. Group companies should be allowed to transfer the benefits of capital allowances.

The granting of the above tax incentives would certainly strengthen the private sector's belief in the

government's determination to encourage enterprises which responded positively to policy pronouncements as well as influence future capital investment decisions in the desired direction.

Regulation on Accounting Practice:

Lack of precise regulation regarding uniform accounting practices/policies is another topical problematic factor in the leasing industry. The practising accountant must be made aware of the implications, problems and opportunities inherent in the intricate financial arrangements that are submerged under most lease agreements.

The Nigerian Accounting standards Board in conjuction with the Federal Inland Revenue and the Equipment Leasing Association should dust up its existing regulations for review in order to provide clear cut guidelines as to uniform accounting treatment of leasing plans by lessors, especially as regards management of residuals, and accounting for secondary lease term. Without the precise policies in place, the current confusion in the market place will continue to subsist thereby compounding the present difficulties of lessors in establishing and realizing definite "yield" expectations.

Needless to stress that such policies should make lease obligations to be footnoted in annual reports, even if they do not form part of the reports. Such disclosure will make banks know company carrying a lease obligation so as to forstall the possibility of such company's (lessees) pledging the same assets to different lessors (banks) under full-pay-out leases.

Need for Competition:

Competition which is one of the greatest stimulants in business is, today, totally lacking in the leasing industry in Nigeria. The Most obvious effect of this absence of competition on the leasing industry has the high pricing on lease financing. The absence of creativity and innovation, and the apparent conservatism present in the industry whereby most lessors will only touch "blue chip" lessee's and are unwilling to finance equipment for concerns often hastly classified as risky is also abundant. Where competition is to be a bit more rigorous lessors will be forced to be more daring, and lessor companies determined to stay in business at a profit, will be forced to educate their staff in order to improve their

quality and assure profitability. What we have today in the leasing industry is a producers market in which demand far outstrips supply, rather than a free market where supply will at least be commensurate with the demand thus instigating growth.

The collapse of oil prices and Government's relaxation of controls has transformed the business environment into a very competitive arena. Many companies are now learning what competing really means. The more mature the industry the faster a company must adapt to the new competitive environment. One could argue that the lack of maturity in the equipment leasing industry diminishes the need to appreciate competitive advantage. This position is a precarious one. The lack of maturity in an industry provides greater scope for existing players to shape the industry in their favour, one only hope this is not the case in the leasing industry today.

As the Federal government continues to licence more and more merchant banks who will give equipment leasing the prominence it desires, we hope competition among the operators in the industry will finally emerge. The new competition should stimulate innovations in products and pricing; the development of market

riches and specialisations. Accordingly, innovative and creative management of tax incentives, after-tax and residual structuring would feature in pricing strategies as lessees, themselves, will become increasingly price sensitive. This will help sharpen the analytical skills of both lessors and lessees and may lead to the eventual emergence and development of other sophisticated lease products such as leveraged leases and vendor programs. The Equipment Leasing Association of Nigeria on its part should ensure that the challenge of competition does not overwhelm its members to undertake acts that will compromise the code of conduct put in place by the Association for its members.

Need for other Sources of Funding:

As stated earlier the sources of funds for Merchant Banks and consequently for leasing is limited (mostly short-term deposits), the competition for the limited funds are high, leading to higher rentals than they would be in a freer market.

To give funding for leasing the leverage it needs and to entice investors into equipment finance, relief should also be allowed on dividends on equity investments as well as interest earned on lease finance

transactions. Tax control in Nigeria is still relatively primitive and should investors perceive equipment finance as a high yield area more money will be available for equipment leasing, thus increasing the productive capacity of our industries. This will provide a greater tax yield in the long run. Such encouragement will bring more funds and invariably, more players into the market. The Banks will remain the key players shaping the industry, and by this the momentum of funds attracted will escalate providing more money for lessors to draw on and banks will be encouraged to go for leasing subsidiaries.

Need for better credit Policy:

Apart from the normal criteria for credit risks evaluation, lessor demand other numerous information that has to be disclosed before a prospective applicant can be extended the opportunity of lease financing. Thus, the present criteria for credibility is too rigid for a growing economy like ours.It has also become increasingly evident that what we need in Nigeria today is:

a) A progressive credit policy that can adjust to accommodate what changes there may be prompted by the economy.

b) Experts capable of analysing and moving with the market trends.

c) Finance controller who will be able to control the direction and funding of companies needing lease finance.

Stable Exchange Rate:

The erratic and frequent changes in the fiscal/ monetary policies of the country is by far the most serious of all the problems, and so much has been written and said about its overwhelming negative effect on the economy that it hardly requires anymore emphasis. Suffice it however to mention that this factor has been responsible for the inability of most indigenous firms to take advantages of lease financing alternative, as well as the sudden demise of many cut up by many of these policy changes, especially the recent ones concerning interest rate deregulation and FEM.

Unlike in more stable economies, where the lease rental paid by the lessee is fixed throughout the lease period, due to stable interest rates, in Nigeria due to the market situation and government policies, interest rates change on all loans, lease inclusive. This means that for a lease averaging a maximum of 5 years, rental payments throughout that

term will vary. This makes leasing very expensive in the long run.

Unattractive exchange rates could stifle new capital expenditures, or temporarily delay such expenditures as sponsors wait for a more opportune time to commit themselves to new plant and machinery. This trend would have serious consequences for employment and overall economic recovery. The issue of foreign exchange availability and the rate at which it is made available is critical to the business of leasing (since most equipment are still imported) Banks, in a bid to satisfy a wider Group of customers, have resorted to "Blended Rates" (i.e. a weighted average of autonomous and FEM rates) for financing capital expenditure and this has serious consequences for project sponsors.

The market's response in terms of solving this problematic factor has been at best palliative, since the banks are still far removed from the policy initiating and policy making bodies.

Need for Trained and Experienced Financial Engineers:

Some of the findings on some leases currently witnessing some distress concern the stereotype nature of most of them. This factor has been attributed to

the death of experienced and trained personnel in most of the merchant banks. It is obvious that the adequate development of the responsible leasing staff in some of these institutions has not kept pace with the growth in demand for finance lease facilities. As a result, most of the consumated leases have been stereotyped in order to beat the rush to book leases, without adequate care being taken to thoroughly evaluate the peculiarities of the applicable leasing plans, and structuring them accordingly. It need be highlighted that leasing as a creative financing vehicle requires the highest calibre of intelligent, dynamic and trainable staff in order to be able to match its discriminatory demand for high flying financial engineering expertise.[4]

The challenges ahead required merchant banks to intensify the training of their leasing staff in order to ensure acquisition of requisite skills needed for coping with the volume and technical expertise demands that will result from the projected increased requirements for finance leases.

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4. CHIKE NWEGBE: "Structuring Leases - Problems and solutions (prospects and challenges)" Paper presented on the 5th anniversary of ELAN. 1985.

Viable Projects:

Most prospective lessees interviewed did not subscribe to the merchant banks' claim that there is the general lack of viable projects in the market to be financed via leases. They inturn claim that the merchant banks requirements are too rigid and numerous, especially in this present harsh economic climate.

To adequatly tackle this problem merchant banks should advise their customers on viable projects, available in the market that will aid the growth of their business. The merchant banks should also publish their activities both in the money and capital market, so that their customers and the public at large can know and appreciate their role particularly in medium and long term financing. As it is now not many companies know much about equipment leasing as an alternative form of financing capital equipment.

The regulatory body (CBN) should also keep a close surveillance on the merchant banks to make sure that their activities are fully directed towards medium and long term financing in the economy as specified by the CBN guidelines. This is necessary

because these are the specialised area in which they are expected to contribute more meaningfully to the industrial development of the country. Specifically, the CBN should henceforth prescribe a penalty for banks who fail to meet up to 60 per cent of the 15% maximum expected to be devoted to equipment leasing by merchant banks.

Another way the monetary Authorities can help fund leasing is by extending the privilege of taking deposits from the public to leasing companies. This is done successfully in India. This would free the leasing industry from the risk averse method of financing by banks.

Merchant banks can also seek alternative means of financing lease transactions through large leasing companies in advanced countries by discounting whole blocks of leases from leasing companies in the country and obtaining high spread by so doing. This is one area where the leasing industry can develop cross border leasing without actually involving the cross bearer lease of equipment.

4.2. FUTURE OUTLOOK AND CHALLENGES:

The equipment leasing industry in Nigeria today

is an attractive one. There are relatively few players and a number of viable strategies exist which can be successfully employed. The future of leasing in Nigeria appear very bright because the economic conditions are ripe for it to get entrenched. Many companies are having right now serious liquidity problems because of the economic recession. In order to maintain their growth rate, they must lease equipment, buildings, plants and the like. Infact it is now becoming evident that leasing is gradually replacing other mainstream medium and long term loans, as the fastest growing means of fixed asset financing instrument. But the regret is that so far, it is mostly the schedule 3 companies that appear to be benefiting from this development, to the exclusion (or is it ignorance?) of the small to medium scale indigenous enterprises that provide the bedrock of our economic emancipation and growth.

In view of the undisputable strong prospects for leasing business in the country, the challenges the operators in the industry - ELAN - face in ensuring that the benefits are optimised and strategically focussed to benefit the country can be opportioned as follows:[5]

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5. Ibid.

a) Regularly meeting with relevant Federal Government Agencies with a view to ensuring that appropriate regulations for leasing businesses are enacted accordingly.

b) Acting as a central clearing house for all information that will facilitate the transaction of leasing business in the country, including a computerised data base open to, and, useful to all comers in the industry.

c) Instituting a code of conduct for its members in order to streamline leasing business practices in the country.

d) Laising with international lease clubs with a view to enabling members access training and on the job attachment programs for the overal development of requisite manpower skills and expertise. Contacts with these overseas clubs is important in ensuring that Nigerian equipment lessors are in touch with latest development in the international market place. I am particularly happy to know that the Association is represented annually at the world leasing conventions.

As Merchant Banks face the challeneges ahead they should not allow the present windfall overwhelm them to take acts that will compromise the code of conduct put in place by the Association for its members. They should take caution while the windfall lasts. As the dynamism of the maturing industry continue to evolve, they should put the right structure in place for a dynamic leasing association which will represent and serve the industry.

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