THE IMPACT OF FINANCE LEASE ON THE PERFORMANCE OF NIGERIAN BANKS

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CERTIFICATION

This thesis entitled THE IMPACT OF FINANCE LEASE ON THE PERFORMANCE OF NIGERIAN BANKS by Hassan Usman Shehu meets the regulations governing the award of the degree of Master of Science (Accounting and Finance) of the Ahmadu Bello University, and is approved for its contribution to knowledge and literary presentation.

……. ……

Chairman, Supervisory Committee Date

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Member, Supervisory Committee Date

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Head of Department Date

..... …….

Dean, Postgraduate School Date

DECLARATION

I declare that the work in the thesis entitled IMPACT OF FINANCE LEASE ON THE PERFORMANCE OF NIGERIAN BANKS has been done by me in the Department of Accounting under the supervision of Dr Musa Inuwa Fodio. The information derived from the literature has been duly acknowledged in the text and a list of references provided. No part of this thesis was previously presented for another Degree or Diploma at any University.

HASSAN Usman Shehu
(M.Sc/ADMIN/45410/2004-2005)

DEDICATION

DEDICATED

TO MY

BELOVED MOTHER

Maryam Hassan Karim

ACKNOWLEDGEMENT

In the name of Allah, the Most Gracious, the Most Merciful. May His peace and blessings be upon His messenger Prophet Muhammad (SAW).

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Hassan Usman Shehu
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ABSTRACT

The issue of inadequate capital remains one of the major challenges of business entrepreneurs in Nigeria. Business firms are constantly searching for ways to expand their operations and deliver quality services and increase revenue, while the new ones want to start in good shape but enough funding is not readily available. Leasing has been long established as a creative financing tool for the acquisition of capital assets. Over the years, leasing has grown into an industry of imposing scope, and greater potentials are met through this unique form of financing.

This study examines the impact of finance leasing on the performance of Nigerian banks.

The population of the study consists of twenty (20) banks that are quoted on the Nigerian stock exchange and members of ÉLAN as at 31st December, 2005. The sample of the study is five (5) banks drawn randomly from the population of the study.

The study uses linear regression as a tool of analysis to assess the impact of lease financing on profitability, investment and shareholders fund of the selected banks.

The study establishes that finance lease has no significant impact on the performance of Nigerian banks despite the relationship between them is positive.

The study concludes that finance lease has no significant impact on the performance of Nigerian banks and therefore, recommends among others that Nigerian banks should increase their commitments into leasing business to improve earnings from the proceeds of leasing and be leasing buildings and office equipment instead of building and buying them at the event of expanding or opening new branch.

List of Tables

Table 4.1 Aggregate values of Dependent and Independent Variables ……..……..... 63

Table 4.2 Determinants of Impact of Leasing on the Performance of Nigerian Banks……. 64

Table 4.5: Performance Appraisal of Nigerian Banks…….. 68

Table 4.6 Five Years Nigerian Banks' Performance Rating…….71

TABLE OF CONTENTS

Page

Title Page……. ii

Certification …… iii

Declaration…….. iv

Dedication……... v

Acknowledgement…….. vi

Abstract…….. viii

List of Tables……. ix

Table of Contents…….…….. x

Chapter One: Introduction

1.1 Background of the study……..……. 1

1.2 Statement of the Problem……...….. 6

1.3 Objectives of the study……. .8

1.4 Research Questions……9

1.5 Research Hypotheses…….…… 9

1.6 Significance of the study…….. 10

1.7 Scope of the study……. 10

1.8 Plan of the study…… 11

Chapter Two: Literature Review

2.1 Introduction…… ..12

2.2 Historical Background of Leasing……. ..13

2.3 Concept of Leasing……. .18

2.4 Lease Financing by Nigerian Banks……..... 38

2.5 The Impact of Leasing on the Performance of Banks……. 43

2.6 Theoretical Framework…… 50
2.7 Summary……53

Chapter Three: Research Methodology

3.1 Introduction……..54
3.2 Basic Research Methods and Design……..…….....55
3.3 Population and Sampling Techniques……..58
3.4 Sources and Method of Data Collection…… ….59
3.5 Techniques of Data Analysis…….…..60
3.6 Justification of techniques of Data Analysis……..… .61
3.7 Summary…….... .61

Chapter Four: Presentation and Analysis of Data

4.1 Introduction…….. 63
4.2 Impact of Leasing on Banks` Profitability…….. 64
4.3 Impact of Leasing on Banks` Investment……..… 66
4.4 Impact of Leasing on Shareholders Fund of Banks……. 67
4.5 Performance Appraisal of Nigerian Banks……68
4.6 Problems Associated with Leasing in Nigeria…….. 71
4.7 Discussion of Findings……. 74

Chapter Five: Summary, Conclusions & Recommendations

5.1 Summary……. 75
5.2 Conclusions…… 76
5.3 Recommendations……..…. 77

Bibliography…….. 78

Appendixes……. 85

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

One of the most prominent issues in the corporate and financial world today is the issue of leasing (Abashiya, 2005). In the developed countries, it is almost an integral part of the overall financial system and often advocated as the least expensive and most advantageous form of funding (Afzal, 2003). As (Olusoga, 2003) indicates, the most generally accepted method of financing capital investment throughout the world is equipment lease financing option.

In Nigeria, although lease volume remains relatively insignificant in terms of world rankings, the concept is fast gaining recognition and has been influencing some major decisions in the various sectors of the economy. With the paucity of capital in the continent, many African countries such as South Africa, Zimbabwe, Ghana, Nigeria and recently Egypt have used leasing as a major anchor of their economic development policy with considerable success. In these countries, lessors are fully involved in investments in the extractives industries, transport, agriculture, construction and telecommunications (Olakunle, 2002).

Leasing has been used extensively in the financing of ships, aircraft containers, heavy-duty machines, plants and machineries, vehicles, cranes and

bulldozers and assets of substantial value. The concept of leasing is applicable to both medium and long term financing. The essence of a lease contract is that the user and owner remains separate and the former pays the latter a regular rental for the use of the asset (Higson, 1990).

Firms use buildings and equipment in the production of goods and services. One way of obtaining these is to buy them, but an alternative way is to lease them. Prior to the 1950s, leasing was most often associated with real estate, land and building. Today however, it is possible to lease virtually any kind of fixed assets (Weston and Brigham, 1981).

A common decision faced by firms is whether to buy an asset by issuing debt to finance the purchase or to simply lease the asset. These alternative financing options have attracted a lot of studies and models. In a lease context, the debate has become enshrined in the phrase; “Lease or Borrow”, and “Lease or Buy”. (Bloomfield and Ma, 1974). Should firms be deciding between leasing and borrowing a purely financing decision, or between leasing and buying, or a combination of the investment and financing decision?

Becchy (1970) model is structured to determine the percentage of alternative costs while that of Vencil (1969) generally referred to as Vencil lease valuation model is for evaluation purpose. In lease or buy decisions the expected cash flows (revenue or cost savings) from using a facility are presumed to be the same to the

user whether the facility is leased or purchased outrightly. The evaluation process therefore concentrates on the cost differentials (Okafor, 1983). The lease-versus-purchase decision is based on cost benefit analysis. In the analysis, both quantitative and qualitative factors that affect the decision are considered (Kurfi, 2003).

Lease facilities are often easier and faster to obtain than term loans. The equipment under lease serves dual purpose, facility and collateral, since ownership actually remains with the lessor and not the lessee. This also serves as the main reason why financial institutions embrace equipment leasing, as it is safer and in the event of rental defaults by lessee; the lessor can withdraw the equipment (Abashiya, 2006).

The privatization, deregulation and industrialization policy of the government of Nigeria further lends support to the growth of the leasing sector as a shift to private sector is likely to lead to prudent asset management, better utilization of resources and higher demand for long-term finance, adding to the strength of an already increasing investment growth rate. Leasing therefore, is poised to out-perform almost all other forms of financing such as loan or outright purchase because of its cheapness (Abashiya, 2005).

According to Olusoga (2006), leasing being a creative financing alternative for the enhancement of capital formation, makes an ideal instrument for financing

of the much needed infrastructure. Generally, leasing is an important source of medium-term and long-term financing which facilitates economic development through increased financing flows to the productive sectors of the economy, growth of domestic production and increased financing options for private business. With increasing demand for the flexibility and convenience that leasing offers, it is not surprising that its popularity is growing in leaps and bounds.

The fundamental benefits of leasing that have existed for so many years continue to provide impetus for the growth of equipment leasing. These benefits, combined with the creativity of the leasing industry, will continue to increase the acceptability of leasing as a means of financing the acquisition of equipment. Leasing has proven to be a more successful alternative to funding businesses as cash is not given to the operators but the equipment they need and rent is paid to the lessor based on the lessee's turnover (Akinde, 2006).

There is a large demand for asset financing among micro- and small enterprises. Current leasing companies and banks all have the opportunity to tap into this market. While there are general strategic considerations that any of these institutions would have to take into account, some considerations are peculiar to the specific type of institution involved. To evaluate their capacity to venture into micro- and small enterprise leasing, financial institutions including bank subsidiaries, leasing companies and individuals must examine human resources

and training needs, delivery channels, management information systems, risk management, product design, financial implications, legal and tax implications and social impact (Brand, 1998).

However, the present improvement in the Nigerian telecommunication sector is another opportunity for the business of leasing to do well. The ability to attract capital is very paramount to the success of the telecommunication sector due to the capital intensive nature of the industry. The industry relies heavily on external sources of funds including lease financing.

Telecom leasing in the developing countries like Nigeria involves mainly cross-border transactions due to the high capital outlay involved and the fact that most operators are foreign companies. In Nigeria, operators particularly the Global Satellite Mobil (GSM) companies are major participants in these cross border lease transactions. For instance, one of the GSM operators has secured $1.2m lease facility from an American Company in its bid to expand capacity (Olusoga, 2003). The increasing use of Information Technology by all sectors of the economy has made leasing to become an alternative means of acquiring modern and up to date Information Technology (IT) infrastructure. This is particularly so in the financial service and manufacturing industries where the cost of acquiring modern technology can appear to be prohibitive.

Over the last three to four years, in a bid to ensure that the standard of living of Nigerian citizens improves and the acquisition of assets is made easier, a number of financial institutions have developed products that revolve around the leasing of household assets. Although this is new to Nigeria, it has been the standard practice in the United States and Western Europe for at least 30 years (Lemo, 2004). This points to the ability of leasing to contribute significantly to welfare, which is one of the most important indices of economic development.

According to Mamman (2006), leasing has been accepted as an important means of financing assets in Nigeria. Its prominent acceptance is as a result of the far reaching economic reforms under the Structural Adjustment Programme (SAP) introduced in the 1980s. One of the quickest outcomes of the programme was a downward adjustment of the Naira exchange rate through the Second Tier Foreign Exchange Market (SFEM) from about N1.50k to $1 in 1986 to about N140 to $1 in 2003. This led to high cost a assets and scarcity of foreign exchange to pay for import.

Furthermore, tax and accounting are special attributes of leasing that make it important to distinguish between finance and operating types of lease. The type of lease determines who among lessor and lessee gets the capital allowance from the federal Inland Revenue Service (FIRS) and how the leasing transaction is recorded in their respective books of accounts. This study emphasizes on finance lease.

In Nigeria, outstanding lease volume in 2005 was N115 billion and the contribution of the industry is becoming more pronounced in the various sectors of the economy (ELAN, 2005). Worldwide, leasing has been a significant tool for aviation financing. For instance, in the last decade, the Japanese financial institutions financed about 50% of the commercial aircraft deliveries and provided about $96 billion in leverage lease financing. Also, from the present estimate of $25-$30 billion external financing requirement needed annually for capital expenditure by airlines, leasing accounts for about $12.1 billion. Similarly, 25% of the 24,000 commercial jet aircrafts in service are owned by leasing companies. Over 150 leasing companies and 120 banks are currently involved in various financing arrangements for the aviation industry (Olusoga, 2006).

According to Olayinka (2006), competition between leasing companies and banks engaged in leasing business appears to be on the rise as small and medium enterprises turn to leasing for alternative source of funding. He also observes that in many countries of the world leasing is now being used as a means of empowering the small and medium enterprises and some other sectors of the economy and is being encouraged by the International Finance Corporation (IFC).

The major players in the Nigerian leasing industry are banks, finance houses and investment companies (Olusoga, 2003). Leasing activities in Nigeria has increased significantly over the years especially in the banking sector (ELAN,

2004). This is clearly indicated by the number of firms and individuals that are members of Equipment Leasing Association of Nigeria (ELAN).

This study focuses on banks for the fact that it is perhaps not an exaggeration to say that every bank in Nigeria now participates in leasing; because if not involved as lessor or lessee, it will at least be involved in financing a leasing transaction or playing an intermediary role. In addition, most of the large leasing transactions in volume are undertaken by the banks. It is also only the banks among the other players in the Nigerian leasing industry that act as Lessors, Lessees, financiers or intermediary parties and there is non of the other players that does not use banking services to facilitate its dealings in leasing transaction. The primary role of financial institutions is financial intermediation. It is our expectation that, as this role is better understood and accepted by the public, leasing will become increasingly intertwined with the economic development of the Nigerian economy, since leasing is a natural means of financial intermediation.

1.2 STATEMENT OF THE PROBLEM

The issue of inadequate capital remains one of the major challenges of the business entrepreneurs in Nigeria. The existing business firms are constantly searching for ways to expand their operations and deliver quality services and increase revenue while the new ones want to start in good shape but enough funding is not readily available.

Leasing has been long established as a creative financing tool for the acquisition of capital assets. Over the years, leasing has grown into an industry of imposing scope and even greater potentials are met through this unique form of financing. For example, small companies may lease to conserve cash and large profitable ones may lease to keep bank credit lines open for other purpose (Olakunle, 2002).

Therefore, leasing could be the right solution but the capacity of leasing to create wealth for the business sector has not been fully embraced in Nigeria (ELAN, 2004). In Europe the situation is almost the same (Giobanoli, 2005). The classification of finance leasing in private law remains controversial and various views are expressed with regard to this question.

However, many studies have been conducted in the area of leasing to assess how the sector is doing. Lemo (2003) evaluates leasing and economic development in Nigeria. The study examines the contribution of leasing to the Nigerian economy. Ajekigbe (2004) opines that the establishment of virile equipment leasing is a key ingredient in building a vibrant economy.

Wright (2004) evaluates the impact of leasing on the performance of small and medium enterprises in Nigeria. The study concludes that there is a positive impact on the performance of the small and medium enterprises from the perspective of profitability.

The main problem facing accounting for leasing is the disclosure of leasing arrangements (Wolk, et al, 2003). There has been a disagreement about what information to disclose and how it should be disclosed and where it should be disclosed (FASB, 1976). This lead to divergent views on how lease ought to be treated in financial statements (Mamman, 2006).

In relation to compliance with accounting standard on leasing, Gazzel et al, (1999) and Water House (1995) reveal significant compliance with the standard, while (street et al (1999 and Nobes (1998), on the other hand, reveal non-compliance. Mamman, (2006) assessed the degree of compliance with the requirements of SAS 11 by Nigerian firms. The result of the study discloses that Nigerian firms are complying with the requirements of SAS 11.

However, Igbinedion, (2006) critically examines the impact of lease financing on the operations of manufacturing firms in Nigeria and whether it will actually help the firms attain their goals. The study concentrates only on profitability as a yardstick of measuring performance and covers only quoted manufacturing firms. The outcome of the study revealed positive impact on four (4) out of six (6) quoted manufacturing firms examined and negative impact on the remaining two manufacturing firms.

As banks constituted 59% of the corporate members of Equipment Leasing Association of Nigeria (ELAN, 2005), the general expectation is that studies in the

area of leasing would concentrate on the assessment of the impact of leasing on the performance of Nigerian banks. However, none of the prior studies, to our knowledge, has dealt with the impact of leasing on banks. Consequently, it deprived the banks' stakeholders from knowing what role-plays by leasing on the performance of their respective banks. In addition, none of the prior studies, to our knowledge has examined the impact of leasing on the performance of firms from the perspective of profitability, investments and shareholders fund but only from profitability alone.

The aim of this study, therefore, is to examine the impact of leasing on the performance of Nigerian banks from the perspective of profitability, investments and shareholders fund.

1.3 OBJECTIVES OF THE STUDY

The main objective of this study is to assess the impact of lease financing on the performance of banks in Nigeria. More specifically, the study seeks to achieve the following objectives:

1. To assess the impact of lease financing on the profitability of banks in Nigeria.
2. To determine the effects of lease financing on the investment volume of banks in Nigeria.
3. To evaluate the contribution of Nigerian bank's lease financing to shareholders' fund.

1.4 RESEARCH QUESTIONS

This study seeks to address the following fundamental questions:

(1) To what extent is lease financing increases the profitability of banks in Nigeria?

(2) What is the contribution of lease financing on investment of banks in Nigeria?

(3) What is the relationship between lease financing and shareholders fund in Nigerian banks?

1.5 RESEARCH HYPOTHESES

In line with the research questions, the following hypotheses have been formulated in the null form.

$H0_1$ Lease financing has no significant impact on the profitability of Nigerian banks.

$H0_2$ Lease financing has no significant impact on the investment level of Nigerian banks.

$H0_3$ Lease financing has no significant impact on the shareholders fund of Nigerian banks.

1.6 SIGNIFICANCE OF THE STUDY

Since many studies have been conducted on leasing and firms of different industries and most of the outcomes shows positive impact of leasing on the firms, this study will serve as a pioneering effort of assessing the impact of leasing in the banking industries.

This research will serve as a reference material for the academic community by enhancing the knowledge of readers and those interested in further research in the area of leasing.

It will also be useful to shareholders of banks to know the impact of leasing on their fund. This will enable them to influence an increase of leasing activities in their respective banks.

It is hoped that the result of this study will be of benefit to all participants in a leasing business especially to all members of ELAN in creating more awareness about leasing in Nigeria, which will improve the patronage and level of their business.

The management of banks used in this study will find the study very useful because it highlighted the benefits of lease financing on the activities of their banks.

Government and its agencies will also find this study useful, since it highlights the need to standardize the legal aspect of leasing in Nigeria.

1.7 SCOPE OF THE STUDY

This study lays emphasis on the contribution of lease financing to the Nigerian banks. The population of the study is 20 banks that are quoted on the Nigerian Stock Exchange which are the only banks among the corporate members of Equipment Leasing Association of Nigeria. The study selected 5 banks

representing 25% of the population as sample of the study, using systematic sampling technique.

The period of the study covers 5 years from 2001 to 2005. This period covers the various reforms introduced by the Equipment Leasing Association of Nigeria (ELAN) in order to boost the business opportunities of its members.

1.8 PLAN OF THE STUDY

The remaining part of this research work is divided into four chapters as follows:

Chapter two reviews existing literature related to the research topic. Chapter three deals with the methodology of the research; It discusses the methods of collecting data, population and sampling as well as tool of data analysis. Chapter four presents and analyses both the primary and secondary data collected in the course of this research work. Finally, chapter five presents the summary of the work, conclusions and recommendations.

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

Most countries throughout the world now utilize leasing to facilitate capital formation (Abashiya, 2006). Its importance in financing assets use has been long established (Weston and Copeland, 1998). Its penetration in the market compared to other methods of financing capital placed it as one of the major ways of breaking poverty circle (Global Leasing Report, 2000). Over the years, the business of leasing has continued to grow as more and more of the assets in the world are financed through leasing. This has made projects that would have otherwise been regarded as unviable successful.

It is evident to both outsiders and insiders that leasing industry is very dynamic because of the rapid growth and development of the industry. (Ndakatsu, 2000). Now more than ever before, all types of assets and equipment such as Computers and Printers, Typewriters, Photocopy Machines, Buses and Vehicles, Trucks, Cranes, Generators, Aircrafts, Ships and vessels, Satellites and generating Plant and Machinery of different kinds, are leased. This has led to the emergence of three core segments of leasing market that is, small, medium and large ticket markets. Each market is characterised by range of transaction size and is

influenced by decision factors of the common type of lease product available (Alli, 2003).

The small ticket market concentrates on leasing lower-priced assets that consist of typewriters, duplicating machines and hand tools (Oluwude, 2000). The large market on the other hand is price sensitive, and focuses on highly priced assets and equipment such as Aircrafts, Ships and Vessels, Satellites and steam generating Plant and Machinery. The middle market fills the very wide gap between the small and large ticket markets in both size and complexity (Amembal, 2000). Leasing represents a classical financing tool subjected to debate in accounting, finance, economics and law (Wolk et al, 2002).

This chapter provides an insight into this and similar issues. In particular, the chapter reviews theoretical, survey and empirical studies on lease financing. The chapter begins with a historical development of leasing in Nigeria and conceptualization of leasing in order to portray the nature of the controversies surrounding the subject matter of lease financing. The chapter proceeds with a discussion on the performance of leasing in banking sector as it differs from the other sectors of the economy.

The chapter examines both theoretical as well as survey and empirical works on the impact of leasing on firms. The sections that follow provide detailed discussion.

2.2 HISTORICAL BACKGROUND OF LEASING

Leasing is one of the rapid growing worldwide financing activities (ELAN, 2004). Its market continues to provide greater challenges to appraisers in the entire financial industry. Infact, there is no doubt that leasing has commonality throughout the world (Amembal, 2000). Parts of such commonality comprise of cost of lease amount financed and term residual. Another aspect deals with transition of leasing market.

There is historically documented evidence that the Summenans, a tribe in Southern Iraq, before 2000BC, used a form of operating leasing for agricultural implements and hand tools to farmers (Lemo, 2003). The chartering of vessels, which is the most common form of ship leasing, has also been an important commercial activity since the pre-medieval times.

Later, Babylonians King Hammurabi, ancient Egyptians, Greeks and Romans engaged in lease of personal property, ships, chartered from time of ancient Phoenicians (Beacon, 2004). This is why levinin (1980) Chronicles it incidental in line with it occurrence when he observes that, it is a “Natural” “Inevitable” and ‘External’ alternative to “outright ownership”. Since then, leasing has continued to feature atleast periodically in the commercial activities of most countries, especially advanced ones.

Various significant events have affected leasing industry. These comprise of technological boom, proliferation of sales and financing as well as tax and accounting guidelines have occurred in the past 30 to 40 years (Ndakatsu, 2000). Despite all the changes, the core leasing idea or concept of over 4000 years ago is still part of today's leasing industry. Changes, resulting from globalisation of business and advances in technological flatform have given stakeholders the opportunity to lease and diversify their sources of funding. At the same time seek more cost efficient funding structures that enhance their ability to compete. This is the reason why the industry's development globally is a function of individual country's or geographical region commercial activities (World Leasing Year Book, 2003). Each country or region has its own unique problems and circumstances. However, countries or regions that are experiencing robust economic activities such as those in Latin America, have witnessed rapid expansion of the leasing industry, especially those that are supported by their governments at the same time having strong domestic leasing associations. On the other hand, Asian and Nigerian countries have experienced decline in their leasing industry due to crises in their economics.

The first great leasing transaction was carried out using railway. This was when first London railway, London and Greenwich leased out to South Eastern railway in 1844 (Clark, 1978).

The next is Lombard North Central Company of United Kingdom one of the oldest finance company, that transacted its first leasing activity in 1861. The company undertakes a lease of 20 core trucks costing sixty pound per truck payable monthly. This was however followed by Britain's shoe factory that leased out about 80 percent of it machinery in 1919 (Clark 1978). The very first registered limited liability leasing company was established in U.K. This is in the late 1850's when the new corporate form of entity was established.

The government of United Kingdom is the first to launch organized leasing business in 1960's. This took place in the city of London as a new method of business finance. Active participation of Wagon leasing companies, although for short period and price competition between banks in the U.K. following changes in Bank of England policy in 1972 have contributed in no small way to the rapid development of participation in the industry. These became established model for other forms of leasing that follow.

In the United State (U.S) the leasing activity has its origin in 1700's. This was when personal property such as horses, boggles and wagons by quarrymen were leased out (Beacon 2003). Modern experience in the country had its significant beginnings in 1870's. Bell Telephone Company in 1877 began by leasing telephone equipment in the country. The aim was to provide equipment in

customer's home or office at his convenience without incurring much capital outlay at once.

From then, leasing in the country followed similar pattern to that of UK. It became a fundamental means of financing rail road equipment. Car trust company also known as equipment trust company purchased rail cars for long term leasing to the railroad in 1910's. This was followed by Hughes Tool Company that leased 75 percent of the world's oil drilling equipment (Calm, 1978).

Later, the leasing practices were grapped by manufacturers of boot and shoe making equipment in both UK and US. The present forms of independent leasing companies were established in these countries. The aim was to offer sales-aid leasing or vendor programme. US leasing corporation of San Francisco set the ball rolling in 1952. The influence of the company and others in the same country assisted in the establishment of operations elsewhere. This comprises of merchantile leasing in Britain by 1960, Deutsche leasing in Germany and orient lease in Japan both in 1962 (World leasing year book, 2002).

The developments above mostly arose from the cost implications and/or unavailability of the assets or equipment. However, there are countries where tax factors have contributed to the development (Higson, 1990). Most European counties capitalise on tax advantages in opting for the transaction. It is used to finance large number of equipment and projects that are sheltered from tax

payments. This also applies to UK, where the tax benefits determine quantum of transactions yearly (London financial group leasing, 2003).

Recent years have seen leasing into significant position world over. Countries such as Brazil, Venezuela, Korea, Hong Kong, Singapore, Philippines and other less developed ones recognise its importance. World Bank has been instrumental in getting these advancements (world leasing year book, 2002). In these countries, brokers, consultants and packagers have grown up to advise participants to get the best art of the deals they put through. Added to this is the specialised but substantial international expertise. Auxiliary sources are also growing. These comprise of lease accounting, evaluation asset value insurance and to some extent credit insurance (ELAN 2002).

Leasing is now used by most developing countries as a means of attracting foreign capital. Government and world agencies such as African Development Bank (ADB) and Asian Development Bank (ADB) are encouraging the participation of individual and companies in the business of leasing. The benefit it offers to other advanced countries so many years back continue to make the business acceptable in developing counties.

The concept of leasing has been known and used by humanity for centuries. Prior to the 1950s, the total volume of equipment leasing was relatively small. However, during the second half of the twentieth century, the popularity of leasing

began to grow (Adekunle, 2005). He also pointed that Year after year, for over five decades, the volume of leasing increased to the point where it now accounts for over one-eight of the world's total investment in new plants, machinery and equipment. In 2004, the global leasing industry provided over US $600 billion of finance, making it one of the most important sources of medium and long-term finance in the world (Iniovosa, 2005). In Nigeria, the lease volume has grown from over ₦19.6 billion in the year 2000 to over ₦78.8 billion as at 31 December, 2004 (ELAN, 2004).

Modern leasing was introduced in Nigeria in 1960s. Initially, the business was conducted through subsidiaries of British companies who benefited directly from cross-border leases from British lessors. Equipment leasing by Nigerian companies began in 1972, when post civil war reconstruction efforts gave impetus to the acquisition of heavy construction equipment. The huge capital outlays needed to acquire machinery through outright purchase could not be borne by Government and other organizations in the reconstruction exercise. Many of these organizations, particularly the foreign ones preferred leasing as the best way to obtain the assets.

The first lease transaction in Nigeria was handled by NAL Bank in the early 1960s. This was done through an equipment lease made by Thomas Wyatt (Lemo, 2004). During the 1970s, five merchant banks were granted operating license

bringing to six the number of merchant banks operating in the country. On March 13th, 1983; seven Merchant Banks formed the Equipment Leasing Association of Nigeria (Obaze, 1987). The association expanded to accommodate new merchant banks, commercial banks and the non-banks financial institutions, associations and individuals. The Nigerian leasing industry grew to well over 350 lessors by 1992 (Egbuna, 1995). The volume of equipment on lease in the country grew proportionally to the number of operators in the leasing industry. The membership of the association as at 31st December 2004, was a total of 131 members constituting 42 individuals, 23 associate members and 66 corporate members (ELAN, 2005).

2.3 THE CONCEPT OF LEASING

A lease is a transaction in which an owner of equipment (the lessor) allows another party (the lessee) to use equipment, and for that usage, the lessor charges rent (Euromoney Publications, 1995). It is a contract between a Lessor and a Lessee for the lease of a specific piece of asset. The Lessor retains ownership of the asset while the Lessee uses the asset to generate as much profits as possible, but pays only a small portion of the profits generated to cover lease rentals (Olakunle, 2002).

According to Jacqueline et al (2000), once the two parties enter a contractual agreement over access to and use of the equipment, the lessee is obligated to make

periodic payments to the lessor for the duration of the lease. A lease represents medium term financing for asset usage, usually running for three to seven years. Most lease contracts are characterised by the following terms:

1. The lessor remains the owner of the equipment for the duration of the lease, while the lessee acquires temporary possession and usage of the equipment.
2. The lessee may be required to make a deposit payment on signing of the lease, and to make periodic payments to the lessor for the duration of the lease term.
3. The lessor may or may not recognise a salvage value in calculating the leasing payments.
4. In many instances, the lease cannot be cancelled. Should the lessee cancel the lease, they may be charged a substantial penalty for the cancellation.
5. The lessee is responsible for property taxes, insurance, and repairs and maintenance that are not covered by warranty.
6. When the lease period ends, the lessee has the option of purchasing the equipment, renewing the lease or returning the equipment to the lessor.

Leasing provides a new source of funds for entrepreneurs. Where a company has pledged all its assets to one or more financial institutions and obtaining additional funds becomes an upheaval task and when entrepreneurs are faced with tight credit terms, bank lending restrictions, or other economic factors, leasing becomes the alternative source of funds. Any business entity from sole-

proprietorship and partnership to public and private companies, from small and medium-sized enterprises to big corporations can be involved in leasing business (Wright, 2004).

A lease is defined by the International Accounting Standards Board (IASB) "as an agreement whereby the lessor conveys to the lessee in return for rent, the right to use an asset for an agreed period of time" (IAS, 17). On the other hand, NASB (1991) defines the term lease as "a contractual agreement between the owner (the lessor) and another party (the lessee) which conveys to the lessee the right to use the leased asset for an agreed period of time in return for a consideration, usually, periodic payment called rents (SAS, 11).

From the tax law perspective, a lease has been interpreted by paragraph 1 of the 2nd schedule to the companies income tax Act cap 60 LFN (1990), and paragraph 1 of the 5th schedule to the personal income tax decree to "include an agreement for a lease where the term to be covered by the lease has begun any tenancy, and any agreement for the letting or hiring out of an asset". The laws, however, specifically exclude mortgage from the definition of lease.

Leasing, according to the publication of Equipment Leasing Association of Nigeria ELAN (2004), simply refers to a contractual agreement between the owner of an asset (referred to as the lessor) and the prospective user of that asset (lessee). Having come to agreeable terms, the lessor transfers the use (but not ownership) of

the asset to the lessee and the lessee agrees to pay rentals as compensation for the use of the asset for a particular period of time. At the end of the specific period, which is always less than the asset economic life, the lessee either returns the asset to the lessor or pays a residual value and takes over the ownership structure of the asset.

Leasing is a specialised asset financing service - any institution wishing to establish a leasing business needs to adopt an appropriate, operational and institutional structure to accommodate leasing activities. The institution has to consider which sectors to target, operational requirements, staffing, financing and liquidity requirements, management information systems, taxation implications and the regulatory environment (Mutesasira et al, 2005*).*

Leasing is a method of financing acquisition of property (Baker and Hayes, 1946). They see leasing as a way of financing the acquisition of an asset through agreement between the lessor (owner) and the lessee (user).

The subject of leasing deserves separate treatment from other forms of financing for two main reasons. First, a lease proposal is often a combination of an investment appraisal and financing decision. On that score, lease evaluation procedures differ conceptually from other forms of financing such as loan, hire purchase or mortgage. Secondly, the increasing popularity of leasing in both developed and developing countries is because of its numerous benefits justify

some form of emphasis on the subject. Whether or not a transaction is a lease or a hire purchase is an issue that has generated several litigations with predominantly unpleasant results to legal practitioners. The various attempts to force leasing into the existing legal classifications, have invariably failed to solve the issue, as each practitioner has naturally tended to interpret leasing according to his understanding (Olakunle, 2002).

Section 20 of the Hire Purchase Act, defines hire purchase as “the bailment of goods in pursuance of an agreement under which the bailee may buy the goods or under which the property in the goods will or may pass to the bailee”. From the above definition, the two major characteristics of a hire purchase agreement are firstly, the bailment of goods under an agreement in which the bailee may buy the goods i.e. an option to purchase or an agreement under which the property in the goods will pass to the bailee i.e. although the hirer could terminate the agreement at any time, the goods will be his if he completes payment of the hire purchase price.

According to Law Dictionary a lease when used with reference to tangible personal property grants to another the right to possess, use and enjoy it for a specified period of time in exchange for a periodic payment of a stipulated price referred to as rent. It differs from hire purchase agreement in that the lessee in most instances is not given an “option to purchase” the asset like in hire purchase

agreement. This appears to be the position of our courts in interpreting the law as to whether or not a transaction is a lease or hire purchase like in Raimi v. Akintoye 1986, 3 NWLR part 26, G. B., Olivant vs. S. Akinsayon 10 NLR, Jay Kay Foods Ltd vs. C & I Leasing Plc (on reported suit no. 1/964/99). In practice, many finance lease agreements contain an "option to purchase" the asset at the end of the lease term in order to reflect the true intention of the parties i.e. that the lessee becomes owner at the end of the lease term. From the explanation above, there is the tendency for such an agreement to be construed as hire purchase.

In order to take leasing out of the purview of hire purchase transaction, any or both the offer letter and lease agreement should not contain the "option to purchase" clause. The following steps can be adopted to achieve the intention of the parties:

1. A contract of sale independent of the lease agreement can be executed between the lessor and the lessee.

2. The lessee can be required to nominate a third party to purchase the asset.

3. The lease agreement could contain a clause providing for secondary period after the initial primary period during which the lessor must have recouped his investment and necessary returns (Olakunle, 2002).

While hire purchase is similar to the finance lease in many respects, there are two features that distinguish them:

1. With hire purchase, the lessee assumes increasing ownership of the asset with each payment made. On the other hand, in the financial lease, the lessor retains full ownership of the asset until it is fully paid for.

2. The down payment is considered an installment payment towards asset purchase in hire purchase. However, in the finance lease, this down payment is regarded as additional security and not a payment towards asset ownership.

Okafor, (1983) defines a lease as a contractual relationship through which the possession, the right to use and the right of control over an asset is transferred from its bonafide owner to a user in consideration for periodic rental payments. The owner of the property is the lessor, the user is the lessee and the periodic rental is called the lease premium. A lease enables the lessee to substitute periodic lease premiums for a lump sum that would have been required for outright purchase of the asset.

Conceptually, a lease can be arranged for any length of time. Some lease contracts are for indefinite periods, in the sense that they contain automatic renewal provisions. Such leases represent a combination of two separate contracts the primary contract, which covers the first period of the lease, and the secondary contract, which stipulates the conditions for renewal.

Emeka, (2004) views leasing as a contract between a lessor and a lessee, giving the lessee possession and use of a specific asset for payment of rentals over

a period. The lessor retains ownership of the asset so that it never becomes the property of the lessee or any other related third party during the tenure of the lease.

Leasing, is a form of renting used by businesses or individuals to finance the acquisition of land, building, machinery, and other industrial equipment. It is widely used by companies in preference to outright purchase because of a tax advantage and less financial capital needed at the time leasing agreement is taken out (Redmond, 2006).

From the definitions above, it can be deduced that leasing is an agreement between an equipment owner and a user of the property. The user pays the owner a periodic rental fee as compensation for the usage of the asset under lease. It can also be seen that all the definitions have portrayed leasing as contract or agreement between two or more parties which consist of all elements of valid contract. Therefore, irrespective of the perspective considered, the leasing will not go out of contractual frame work.

Leasing as a multi-disciplinary subject is more complex than is being considered by many lessors. A thorough understanding of the intricacies involved in leasing will no doubt help the lessor to avoid or mitigate the risk of default. The lessor should equally ensure proper documentation of the transaction. The main document in this regard is the lease agreement. It is important that the lessee agreement be well drafted, taking cognizance of, intricacies of leasing, the rights

and obligations of the parties and other relationship in the transaction. There must be measures specifically adopted to safeguard the investment of the lessor. Failure to ensure proactiveness of any of these issues may eventually spell doom for the lessor particularly with hindsight of serious delays in obtaining legal redress.

2.3.1 **Parties to a Lease**

According to Emeka (2004), the parties to a basic lease are the lessor and the lessee. The Lessor provides the equipment to be leased and may supply service and add value as well. Lessors purchase, manage and in some cases remarket equipment as part of the lease process, and tailor the financing to fit the needs of the user.

The Lessee is the user of the asset. The lessee has possession but not ownership of the asset on lease. The servicing and financing needs of an asset on the part of a lessee are critical in the development of an appropriate lease agreement.

The Lender (Individual or Bank), quite often a third party might be involved in a case, particularly if it is a leveraged lease, where, he has to provide a substantial part of the funds needed to finance the acquisition of the asset as collateral pledge for the loan and receives the principal sum lent and the interest there on from the lessor (Emeka, 2004).

Sometimes, a lease is facilitated by a Lease Broker, who acts as an intermediary between the Lender or Lessor and/or the Lessee. The broker may be an investment banker, finance house, accounting firm or independent consultant or even a firm of legal practitioners.

In leasing, the first rule to observe is that the ownership of the asset being financed is vested on the borrower. The lessee, who usually pays lease rentals at regular intervals in advance either monthly, quarterly, half-yearly or annually (Olusoga, 2005).

The process usually starts when a potential lessee makes a decision to acquire equipment. The lessor may assist the lessee in selecting and ordering the equipment. The lessee will negotiate the purchase terms with the supplier. Where the lessee decides to use lease finance and agrees on the terms of facility with a lessor, the following procedures are followed:

First, the lessor or bank places the order for the equipment directly with the supplier and signs the purchase order.

Second, the lessor can also appoint the lessee as his agent to place the order for the equipment notifying the supplier of the equipment, name and address of the lessor to which the invoice will be sent to for payment.

Third, the lessee can also pay for the equipment and subsequently turn to the lessor for re-imbursement by either disclosing the fact that he is acting as an agent or

making contract in his own name concealing that he is acting as a representative Abashiya (2006).

Where the lessee has already purchased the equipment before entering into the lease agreement, the lessor may acquire the title to the equipment in three ways:

1. A new order from the lessor releasing the lessee of all liability, to the supplier replaces the existing order and contractual agreement between the lessee and the supplier.
2. The lessee will assign a purchase order to the lessor with or without the consent of the supplier thus, the lessee remains liable to the supplier for the performance of his obligation.
3. The lessee would turn back to sell the equipment to the lessor and the lessor would lease it back to the lessee Abashiya (2006).

According to Ibrahim (1992) before the funds in any lease transaction are disbursed, the lessor usually makes sure that the following documents are fully executed.

1. Application to lease**:** This usually includes the full legal name and address of lessee and any guarantor, description of the equipment, price of the equipment, discount or any other charges, location of the equipment, specification in terms of quality, quantity, mode, make, and serial number,

the selling equipment, terms of payment, lease term, amount of each lease payment, advance payments and security deposits (if any).

2. Proposal/commitment letter**:** This informs the lessee the major items and conditions of the lease. The letter covers such items as identification of the equipment, cost of the equipment and the date by which the equipment must be delivered.
3. Master lease agreement**:** This is the heart of the transaction because it covers all the provisions of agreement between the lessor and the lessee. It also sets out the terms governing all subsequent schedules added.
4. Lease schedule**:** This explicitly states the terms of payment including a detailed description of the equipment and a purchase /renewal option.
5. Purchase/renewal option**:** This document sets out the price the lessee is to pay for the equipment at the end of the lease term, if the lessee desires to purchase, and the renewal price of the equipment, if the lessee choose the alternative.
6. Certification of delivery and acceptance purchase order**:** A bank must have the certificate of delivery signed before making disbursement to the vendor.
7. State's sales tax or exemption where applicable**:** Olusoga (2003) opines that major part of the yield is the tax benefit of depreciation on those benefits are severely reduced, if the lease ends before the original term.

8. Tax indemnification: This is designed to protect the lessor. One of such agreements calls for the lessee to indemnify the lessor against any possible event, which could affect tax portion of the yield.
9. Interim lease**:** This refers to terms, conditions, and date of master lease where the leased item consists of several items requiring payments to different times.
10. Corporate resolution and opinion of counsel regarding corporate authority: This identifies the authority under which the corporation enters into the lease, and lists the names, titles and signatures of those officers authorized by the board of directors to enter into a lease agreement.
11. Guaranty which is optional: (ELAN, 1986), states that a guarantee is required either by the lessor when dealing with a corporation or a lessee when dealing with the lessor.
12. Financial Statement: This is only required if the lessee is an existing liability company.
13. Insurance letter: This signifies insuring the equipment to be leased from a registered insurance company.
14. Capital allowance forms: This is obtained from Federal Inland Revenue Service.

2.3.2 **TYPES OF LEASING**

SAS 11, (1991) has categorized leases into two; direct Finance lease and Operating lease. The rights of the lessor and the lessee, their tax benefits and accounting positions constitute the factors, which distinguish them.

Further, Ndu, (2004), Adeleke, (2003), Mclachlan (2004), Kromer (2003), Egbuna, (1995), Lemo, (2003) and Eriki, (1998) all agreed that in leasing business, there are basically two major types of leases namely finance lease and operating lease.

The criteria that determine whether a lease should be treated as finance or operating are such that many leases are capitalized on the lessee's balance sheet. This is not surprising because from a pricing perspective, most lessors prefer to minimise risk by placing as little emphasis on residuals as possible. This allows the lessor to recoup most of the investment and profit from the lease rentals. Consequently, the present value of the lease payments is generally higher than the asset's fair market value.

Finance lease, which is the most common type of lease in Nigeria and the rest of the world substantially, transfers all risks and benefits of ownership to the lessee while the lessor still retains title to the equipment or asset under lease which may eventually be transferred (Adekunle, 2005).

A Finance Lease is a means of financing capital equipment. It is a contract between the Bank (Lessor) and the Customer (Lessee) for the hire of a specific asset, selected from a manufacturer / Supplier of lessee's choice and to suit the lessee's requirements and specifications. The lessee has possession of the asset and uses the same on payment of specified rentals and other usual charges / fees, while the lessor retains ownership of the asset. All the risks (major or minor) and rewards of ownership are normally transferred to the lessee and the obligations are non-cancelable. The lessee is to bear the costs of insurance, maintenance and other related costs and expenses for the leased equipment within the lease period (known as primary or basic period). Usually, after primary lease period the lessee has a choice to exercise a purchase option by paying a specified nominal amount (Ndu, 2003; Alli, 2003; Mamman, 2006, and Abashiya, 2006).

A finance lease, also known as a capital lease, allows the lessee to pay for the usage of the equipment with the option of owning the equipment on expiration of the lease term. The lessor pays for equipment that the lessee has chosen, and the lessee uses that equipment for a significant portion of its useful life.

Furthermore, a finance lease cannot be cancelled by either the lessor or the lessee before the expiration of its primary tenor (SAS 11). The statement of accounting standard No. 11 (SAS 11) paragraph 63 states that a lease qualifies as finance lease if the following conditions are met.

(a) Lease is non cancelable, and

(b) Any of the following is applicable.

i.) The lease term covers substantially (80% or more) the estimated useful life of the asset or

ii.) The net present value of the lease at its inception using the minimum lease payments and the implicit interest rate is equal to or greater than the fair value of the leased asset or,

iii.) The lease has a purchase option which is likely to be exercised.

According to Igbinedion, (2006) the conditions that make lease terminated are as follows:

a. Lessor bankruptcy
b. Enemy country
c. Court order
d. Lessee bankruptcy
e. Leased asset used for other purpose(s)
f. Asset leased to a third party without the consent of the lessor
g. Expiration of lease agreement before a secondary lease agreement.

For a lease to be classified as operating, SAS 11 does not actually defined the operating lease, which somewhat clouds the definitional issues in operating lease structuring instead, SAS 11 defines a finance or capital lease as stated in

paragraph 64 any lease not meeting the finance lease criteria stated in paragraph 63 should be treated as an operating lease. The last criterion of SAS 11 states that a lease is deemed operating only if the present value of the minimum lease payments is less than 100% of the leased equipment fair market value. Payment is generally higher than the assets fair market value (Ndakatsu, 2000).

An operational lease involves the lessee renting an asset over a period of time that is substantially shorter than the asset's economic life. The lessor retains ownership and claims depreciation on taxes. Operating leases generally run for three years or less, and the lessor assumes a share of the risks and rewards inherent in the transaction and anticipates the asset's resale value at the end of the lease term.

Many techniques are used to structure operating leases. Some of these techniques are more conservative than others; some are less conservative. All of them, however, attempt to create a usage (operating lease) agreement in substance not just in form. It is important to remember that merely changing the form of the lease rather than the substance may lead to an improper classification. Fortunately, SAS 11 allows sufficient latitude for structuring operating leases without unduly increasing the risk or improper classification.

A key factor to note is that any operating lease structured by a firm, it must be acceptable to the lessee's audit firm. The lessee's auditors have a final say as to

whether or not a transaction is an operating lease on the lessee's books (Adekunle, 2005).

Three of the criteria are relatively straightforward and are easily avoidable in a lease transaction. For example, a lease either provides for an automatic transfer of title or it does not; it contains a bargain purchase option or it does not. Even the loosely defined second criterion or 80% test is easily avoided when structuring operating leases. This leaves the last criterion as the only criterion that will in most situations, create problems in structuring operating leases.

A basic understanding of pricing is useful in structuring and performing sensitivity analysis of operating leases. This understanding can be used to determine the maximum rental a lessee can pay on a lease and still keeps it operating. In addition, given a known lease payment, the maximum amount of a lessee guaranteed residual that is required to maintain operating lease status can be calculated.

Operating leases are lease arrangements, which should be of particular interest to the equipment users who require specific equipments to carry out specific contracts. The lessors usually provide service such as maintenance, sometimes insurance, support staff, fuel and other running costs of the equipment (Igbinedion, 2006).

According to Ndu (2003), an operating lease is a contract under which the asset is not wholly amortised during the primary period (if any) of the lease, and where the lessor does not necessarily rely on the rentals in that period of his returns but looks for the recovery of the balance of his cost and of his profits from the secondary lease or sale of the returned asset at the end of the lease period. In other words, the operating lease is usually for a shorter period than the economic life of the asset. At the expiration of the initial period, the asset can be lease to the same or to another lessee at a new rentals or the asset can be sold. An operating lease can be cancelled before the end of its tenor by either party. In determining the rentals on an operating lease, the lessor estimates and considers the residual value of the equipment. The lessor provides such additional services as maintenance, insurance and technical support staff provided for in the lease by the lessor. In an operating lease also, the lessor retains practically all the risks, obligations and rewards of ownership. Some of the risk include: value and insured damage. The benefits include appreciation in value. All other variants or lease plans can belong to either one or the other of these two major types of leases.

An operational lease involves the lessee renting an asset over a period of time that is substantially shorter than the asset's economic life. The lessor retains ownership and claims depreciation on taxes. Operating leases generally run for three years or less, and the lessor assumes a share of the risks and rewards inherent

in the transaction and anticipates the asset's resale value at the end of the lease term (Mutesasira et al, 1999).

However, in contrasting between finance and capital and operating lease one may say they are all types of leasing but they differ in various perspectives. Operating lease is cancelable while finance lease on the other hand is not. Scholars have classified finance lease as one that serves as an alternative to outright purchase, while the operating lease does not serve for this purpose (Egbuna, 1996). Further, under operating lease, the lessor takes a risk other than plain financial risk and under a finance lease arrangement; the lessor transfers substantially the entire benefits and risk in incidental to ownership of an asset to the lessee.

Furthermore, it is very important to clearly, distinguish the two types of lease for two major reasons.

a. The type of lease determines how it is recorded in the accounting books of the lessor and the lessee.

b. The type of lease also determines who (the lessor or the lessee) enjoys the capital allowance from Federal Inland Revenue Services (FIRS).

Finance lease is believed the type of lease most entrepreneurs will opt for because the attitude is that we want to own and not just use the asset and also

equipment appreciates in value more often than not (Igbinedion, 2006). While Olakunle, (2002) is on the contrary view that lessees frequently favour operating leases because of the off balance sheet benefits of such leases. Because of this it is important to be familiar with the steps necessary to structure an operating lease.

For accounting purposes, the classification of a lease is important both to the lessor and the lessee, because it determines how the lease is accounted for in the financial statements. Financial and operating leases are classified differently from both the lessor and lessee perspective.

Under a financial lease, the lessor accounts for the lease as a bank would account for a loan. On the balance sheet, the lessor records a net investment in lease receivable and in the income statement, the interest income earned on the outstanding lease receivable. For the lessee's purposes, the equipment is recorded as an asset. A corresponding liability is recorded on the balance sheet. The lessee's income statement captures the depreciation on the asset and the interest on the lease as expenses (i.e. the lease payments are split into principal and interest payments).

On the other hand, for accounting purposes of an operating lease, the lessor is treated as the owner of the asset. The equipment cost is recorded as an asset on the lessor's balance sheet, and depreciated over the lease term. Rental payments received from the lessee are recorded as income on the income statement. For the

lessee's purposes, the rental payments are captured on the income statement as an expense. No record is made on the lessee's balance sheet since the lessee is not the owner of the asset.

Given the two basic types of lease, a number of lease classifications and practices exist, these are:

a) *Sale and Lease Back:* This is an arrangement in which an equipment owner (entrepreneur) sells the equipment to a leasing company or a bank, the leasing company then leases equipment to the seller who uses the equipment in the role of a lessee (SAS 11). The transaction can be of new equipment that has already been put to use the entrepreneurs desire is mainly to raise capital utilising his assets while them continues to enjoy the use of the asset. This we believe is good source of working capital for the entrepreneur.

b) *Sales Aid leasing:* Not all lease arrangements are marketed directly to potential equipment users. Sale aid leasing according to SAS 11, "recognises that a finance programme supports the sales process and that this improves customer service". This arrangement according to Eriki (1998), "involves the manufacturer or vendor of equipment the lessor and the lessee [entrepreneur]. The lessor offers a lease package or an alternative form of finance to assist the manufacturer or vendor package or an alternative form of finance to assist the manufacturer or vendor in

selling its product to the user (lessee) who does not want outright purchase". Sales Aid Lease may be arranged under a direct finance lease or operating lease.

c) *Leveraged Lease:* This is a direct finance lease that involves at least three parties. The lessee, the lessor or equity participant and one or more long term creditors or lenders. The equity participant (lessor) invests about 20 to 30% of the asset value while the lender provides the balance.

The part funding provided by the lender is on a non-recourse basis to the lessor, according to Abashiya (1998), "acquires the asset and gives it on lease, but the lease rental is assigned to the lender".

Furthermore, a trustee is usually appointed to look after the interests of the parties involved. The lessee pays the rental to the trustee, who first apportions the rental towards debt servicing to the lender and makes available the balance to the lessor Abashiya (1998).

d) *Syndicated Lease:* For equipment requiring very high capital outlay or where a lessor wishes to share the risk elements with others, two or more lessors may come together to jointly lease finance such equipment: IAS 17.

e) *Cross Border Lease:* This practice comes into existence when the lessor and lessee reside in different countries Obaze (1987) and Gbede (2002). Cross border leasing is widely used as a sales aid techniques by domestic equipment manufacturers to sell their product. It aids in sales promotion as the entire cost of

the asset can be financed through leasing. Hence, the lessee may like to take advantage of the low cost of funds available in the lessor's country and also benefit from other essential services like maintenance and support staff.

2.3.3 LEGAL ASPECT OF LEASING

In view of the diverse range of opinions on the legal nature of leasing and the consequential effects, it has become imperative for the leasing industry to clarify some of the legal issues in order to aid the operations of parties to lease.

At present, there is no specific law on the subject of leasing in Nigeria (Olakunle, 2002). The practice of leasing is currently governed mainly by the common law and provisions scattered in other laws such as Companies and Income Tax Act, Companies and Allied Matters Act, the Banking and other Financial Institutions Act, Standards for Leases (SAS 11) etc. Clearly, this legal structure is inadequate to cater for the level of sophistication the industry has attained over the years. The nebulousness and fragmentary nature of the legal framework have continued to create confusion in the industry. One major area of concern is that of ambiguity as to the exact legal nature of leasing. This makes the compliance with legal requirements and application difficult. Essentially, it does not present a clear understanding between leasing and other forms of similar commercial transactions such as hire purchase and credit sales.

Apart from Ghana and Egypt that have specific legislation on leasing, the business in Nigeria is largely unregulated. Generally, a host of other laws that impact the leasing markets and practices vary substantially as well. In Uganda and Tanzania, a range of laws relating to hire purchase, contracts, tax, etc, governs leasing. Legal counsel is crucial for any financial institution wishing to go into micro-leasing. Legal interpretation becomes particularly important when clients default, as cases are resolved in court, careful scrutiny of contractual terms and conditions is required (Euromoney Publications, 1995). An auctioneer working for a financial institution in Uganda informed the research team that most banks and leasing companies have been able to avoid legal battles during the repossession process because they are dealing with a legally ignorant public. However, (Selfina, 2001) reports that this is changing as illustrated by lessees occasionally keep loan officers off their premises with court injunctions for trespass.

In Nigeria for instance, the practice of leasing is governed largely by the common law and some provisions of other laws. The leasing market in Nigeria is not sufficiently regulated. No special license or registration is required and there is little supervision. Leasing transactions are subject to both Value Added and Withholding taxes being charged at 5% and 10% respectively. Also, the Tax Law allows lessees to claim capital allowances in finance leases hitherto claimed by lessors. The reversal in favour of the lessee has continued to have a negative

impact on the growth of the leasing industry since most lessors i.e. banks offer finance leases.

Unlike Nigeria, there are conscious efforts in Ghana to regulate the industry. Apart from the tax laws, there are two main laws that regulate the industry. These are the Finance Lease Law PNDC 331 and the Financial Institution (Non-Banking) Law PNDC law 328 (Iniovosa, 2000). The Finance Lease Law, focus on the lease transaction and addresses among other things, an explanation of what constitute a finance lease and the protection of the interests of parties to the transaction against third parties. The Financial Institution (Non-Banking) Law, on the other hand seeks to provide a code of conduct for non-banking financial institutions. The law identified 9 (nine) different types of financial services, including leasing as non-banking activities.

Egypt is one of the countries that have been using legislation to support the growth of the industry. Leasing, as a direct impact of the provisions of the Leasing Law enacted in 1995, enjoys several advantages over traditional commercial bank finance (Olakunle, 2002). These advantages include lesser regulation for the leasing industry, reduced financing costs that allow lessees to deduct fully all lease payments and exercise accelerated depreciation practice over the value of financed assets. Recently, the Law was amended in order to increase the contribution of the leasing industry to the capital formation in the country. The

amendments include increasing the scope of leasing activities to cover leasing of buses and passenger cars for commercial use, facilitating registration procedure of leased assets and reinforcing the repossession process on default.

Legal considerations in leasing are many and complex. The concept of leasing itself is yet to be fully understood by regulators in Nigeria. This has resulted in numerous and at times contradictory and ambiguous laws being put in place to govern the practice. The legal structure has not kept pace with the development of modern leasing transactions. For instance, there is the difficulty in addressing what distinguishes a lease particularly finance lease from other forms of similar transactions like conditional sales or hire purchase.

Whether or not a transaction is a lease or hire purchase is an issue that has generated much litigation in Nigeria, with predominantly ambiguous results. The various attempts to force leasing into existing legal classification have invariably failed to resolve the issue, as each practitioner has naturally tended to interpret leasing according to its understanding. Thus, what started life in Britain as a form of bailment has been absorbed into the Nigerian legal system as something more in nature of a hire purchase or even condition sale.

Equally worrisome, is the inadequate protection of lessors in the event of default. One area of concern is the repossession of leased asset. Generally, judicial process across the continent on repossession is complex and slow unlike in the

developed countries where the process can be concluded within few hours. In Nigeria, quite often, lessees capitalize on the inadequacies of the judicial process to obtain frivolous injunctions against repossession. Many lessors have suffered huge financial losses as a result of the cumbersome process. Also, foreign investors desirous of doing business in Nigeria have shielded away especially after a few unsavoury incidents where in the event of default they could not obtain speedy redress from the court.

Similarly, the absence of registration requirement for both practitioners and leased asset provides an avenue for sharp practices. One of the effects of non-registration of leased assets is multiple leases financing of the same asset in sale and lease back transactions, since the lessor has no means of verifying if the asset being offered by the lessee in the transaction is encumbered. In the case of practitioners, non-registration has turned the industry into an all-comers affair making it difficult to maintain standards.

It is against the background of the various inadequacies of prevailing regulatory regimes that stakeholders in the leasing industry have been clamouring for the enactment of comprehensive leasing legislation. It is the general belief that a specialized legislation will play an important role in addressing some of the major problems of the industry, thus enhancing investors' confidence.

From legal point of view, lease financing can be divided into three major categories as observed by Williams (1978) namely;

a. Sales-lease back of real property.

b. Chattel lease intended as security agreement.

c. True lease of personal property.

The first category involves signing an agreement between lessor and lessee on real property such as; building, land or even part of the building. While the second category encompasses leasing of practical equipment such aircraft, computers and the last part involves lease of personal property.

Codified laws, decrees, and guidelines are normally enforced to direct the ethic of leasing business, which the rules fundamentally will be acceptable e.g. all long lease must be in writing. Unfortunately will be acceptable e.g. all long leases must be in writing. Unfortunately laws in Nigeria are silent in most aspect of lease operation as such many individuals are calling the attention of the government to that effect.

However, some important legal aspects of lease financial need to be looked at:

a) *Lessee's Obligation to Pay Rent:* Lease Contracts always contain an express promise known as a "Covenant" which binds the lessee to make a series of payments in specified interval of a period of time.

Any breach of this covenant by the lessee, will entitle the lessor to reclaim the asset and apply for damages.

b) *Effect of Destruction of the Property:* Richard and Myers (1981), report that most leases contain rules covering the fortuitous destruction of the premises. A typical clause provides that on damage by fire or other fortuitous course, the lessor will repair and restored, and that if the premises are wholly unusable, the lessee's obligation to pay rent will be suspended until the premises are restored, but that if the lessor decides to demolish and reconstruct the premises, the lease will terminate.

c) *Obligation to Repair and Restore:* The lessee is under no duty to make any repairs to the property, unless the lease expressly provides. Also the lessee is not obliged to repair or restore substantial or extraordinary damage occurring with fault or repair damage caused by ordinary wear and tear.

2.4 Lease Financing by Nigerian Banks

Lease financing in Nigerian banks is a form of credit facility mainly to corporate customers by which the bank finances the purchase of plant/equipment under different types of leases. All banks are involved in the business of leasing either as lessors, lessee or financier of a leasing transaction. This can be seen in

their respective financial statements and it is also observed in the financial statements of the banks that most of them are only conduct finance type of lease as lessors or lessees but finance operating lease as third party.

This facility therefore is to enable such Corporate customers have access to the use of certain equipment/machinery on rental basis without having to wait indefinitely until they can purchase their own. In view of the special nature of the facility all requests for leasing facilities are normally forwarded to Corporate Banking Group.

Over the years, the business of leasing has grown into a major industry and has continued to capture sizeable market share from other existing forms of capital finance as equipment users appreciate its numerous benefits, especially the cash flow advantages. Today, there are over 350 established companies engaged in diverse forms of lease accounting for over N150bn worth of outstanding leases (Abashiya, 2005).

In recent times, the number of new entrants into the leasing business has been on the increase. Many investors cutting across various sectors now resort to leasing as a major source of income and are getting more involved in the business. Apart from the traditional players, such as the banks, finance houses, and independent leasing companies. Other investors including insurance companies, manufacturers/dealers, oil service companies, construction companies and even

government have joined the race to take advantage of the immense opportunities leasing offers.

Banks also tend to consider their total exposure when lending to small businesses. If lease financing is obtained through a third party, they are more likely to lend him/her funds than if all of his/her borrowing needs have been met. This is very important if someone has a relatively small business, because most banks expect him to use them exclusively for traditional lending but may not care if a nonbank source for lease financing is used.

In addition to established companies, many individual investors are also venturing into leasing business. These individuals, who are mainly from banks and other financial institutions, have set-up several independent leasing companies across the country operating in the small-medium market segment and specializing in consumer leasing.

The public sector is not left out in this current development. Recently, the Jigawa State Government established its own leasing company - Sub-Saharan Leasing Company Ltd to support the economic development of the state. Similarly, authorities of the Federal Capital Territory (FCT) established Abuja Leasing Company Ltd to take advantage of the numerous opportunities in leasing business. Also, the Federal Government through the Federal Roads and Maintenance Agency (FERMA) recently acquired construction plants and machinery which it intends to

lease to indigenous contractors as a means of building indigenous capacity in the construction industry.

However, all the above mentioned sectors cannot operate the business of leasing efficiently and effectively without the contribution of banks either a parties to the lease or facilitators.

New banks especially those with subsidiary lessor will have bigger capital to work with. It is likely that the banks will engage in big-ticket leases such as leasing of aviation equipments, oilrigs, ships, heavy-duty equipment etc. the area of investment preference is likely to shift from small equipment to big ones since more funds are available for investment in big ticket leases.

There are basically two types of leases in banks which are: The Finance Lease and The Operating Lease.

a) *Finance Lease:* Is the type mostly handled by banks as lessors and it could either be a direct lease or a sales-and-lease-back. (Iniovosa, 2000)

The direct lease involves the bank providing the initial fund to acquire the Equipment, while the sale-and-lease-back involves the original owner of an equipment (i.e. Customer) who is also the user deciding to sell the equipment to the lessor (i.e. Banker) but with a provision that the same equipment must be let to him so that he can continue enjoying the usage. This arrangement is usually done

to ease customer's cash flow position. Rental is spread over the economic life of the equipment and there are usually no secondary lease terms.

Banks are presently concerned with Finance Lease where the Lessor (the Bank) provides the funds to acquire the Equipment. Although the Lessor retains ownership/title documents, the Lessee (user of Equipment) bears the cost of installation, maintenance, insurance and pays rentals to the Lessor.

b) *Operating Lease:* Involves primarily leasing companies and finance houses and deals mostly in small equipment. Therefore, mostly banks acts as intermediary or brokers under this type of leasing While under the Finance Lease the lessee (User) bears the cost of installation, maintenance and insurance, it is not so under Operating Lease, where it is the lessor (Leasing company/finance house) that bears the burden of such charges. The equipment under this arrangement is also leased out to several lessees one after the other i.e. there are options for secondary lease terms.

However, because of the developing stage of this service in the country, difficulties are still being encountered in obtaining from the Authorities the necessary Certification of Acceptance for any written lease which document entitles the Bank to claim capital Allowance (for tax purchases). The procedures for applying lease finance in banks are as follows:

(a) Applications on the customer's letter headed paper for new projects are to be made to the bank and accompanied by the following documentations:

i) Feasibility reports

ii) Copies of Articles and Memorandum of Association and Certification of Incorporation

iii) Projected Cash Flows

iv) Projected Profit and Loss Accounts and Balance Sheets for at least three years.

(b) For existing projects:

i) Audited Accounts of company for the past three years.

ii) Up-to-date Management Accounts.

iii) Cash Flow Projections to cover duration of the projected pay back period as well as Profit and Loss and Balance Sheet Projections Abashiya (2006).

In both cases, invoices or price quotations for equipment from sellers must accompany applications.

In order to ensure effective management of banks leased assets the following steps are taken:

1. All documents such as bill of lading, official invoice, cash receipts and other evidence of payment are all in the name of the bank.
2. The asset is comprehensively insured with bank as loss payee.

3. Name of the bank is clearly inscribed and or labeled/tagged as may be appropriate on the leased equipment.
4. It is ensured that the equipment is timely and adequately maintained. It may be necessary to advise the lessee to contract the maintenance services to a third party that has the technical expertise.
5. The lessee is made to maintain a logbook for recording service report in order to have the history of the working condition of the equipment.
6. It is usually stressed as part of the lease covenants that the “lessee shall use the equipment in a careful and proper manner in compliance with manufacturer’s specifications and shall also comply with the Banks, Federal, State, Local Government and other laws, ordinances and regulations in any way relating to the possession of the equipment”.
7. A register is maintained for leased assets showing the following details:
    a. Name of the leased asset
    b. Serial number
    c. Tag number
    d. Location of the asset
    e. Name of Lessee

f. Service Date

g. Cost of Equipment

h. Residual Value

8. Routine visits is made by a senior branch official to the lessee's premises to check the condition of the asset and that all the above points are being observed at all time. Branches should ensure that periodic rental are debited to customers ordinary account as and when they fall due even if at the expense of overdraft or excess on the account Abashiya (2006). .

2.5 The Impact of Leasing on the Performance of Banks

Studies have attempted to establish position in respect of leasing business. These include the works of Igbinedion (2006), Edward, et al (2006), Wright (2004), Ralph (2003), Olusoga (2003), Mutesasira, Sylvia and Nathenya (2001), Jensen and Meckling (1976) and Fama and Miller (1972).

Igbinedion (2006) establishes that leasing has a positive impact on the performance of Nigerian manufacturing firms. The research covers only the conglomerates out of other categories of manufacturing firms. He uses profitability as yardstick of measuring performance of the firms. He concludes that, the more the size of assets on lease, the more profitable that firm will be.

However, this position is limited to only firms that are quoted on the Nigerian stock exchange and profitability as the only indices of measuring performance. This position may vary if other firms that are not quoted are included and indices like investment size, shareholders funds are considered.

Edward et al (2006) theorized that leasing play a positive contributive role in the financing of aircraft business. Infact they even concluded that no aircraft business from manufacturing stage to sale that will not involve leasing. They however, assessed the impact of leasing on the investment size and profitability of aircraft manufacturing firms.

They conclude that the level of leasing by manufacturing firms determines the level of their investments and profitability. The position however is limited to other factors such as costs of production, price of materials and demand and supply of the aircraft in determining the investment and profitability. In addition, the researchers did not employ any scientific or statistical tool in analyzing the impact of leasing on the profits and investment.

Wright (2004) establishes that size of leased assets in financing small and medium scale enterprises in Nigeria directly affect the performance of the enterprises. In addition, the basis of measuring performance of the indexes used is not mentioned in the study.

According to Ralph (2003), consumers preferred the option to lease the item of their choice on a relatively long – term basis rather than buy it outrightly. He is also of the view that leasing especially of consumer goods in America touches almost the life of every citizen positively. However, despite a depth research, it is limited to only some part of America without considering developing nations whose economies and leasing business is just growing.

Olusoga (2003) establishes that an increase in level of activities of telecommunication industry improves the volume of leasing in Nigeria, which implies that there is a direct link between the telecommunication and leasing industries. She concludes that an increase in telecommunication activities increases volume of leasing in Nigeria, but increase in activities of leasing does not affect telecommunication positively. However, this assertion may be different with time span and technological advancement.

Mustesasira, et al (2001) opines that leasing has significant impact on the demand and supply of products specifically targeted toward asset finance in the micro – small enterprises in East Africa.

Therefore, with much leasing activities, the demand and supply of those assets to be leased will increase. High demand makes the manufacturers to increase supply and meet the demand. In addition, despite it is obvious high demand attracts much suppliers but there are other factors that may likely vary the position. These

factors maybe price, unavailability of loan or requirement that is qualateral and enough capital.

Jensen and Meckling (1976) also theorized that risky leased assets directly increases investment size of firms; that with savings made through leasing over outright purchase, there will be fund available to invest.

This theory however addressed the period when the world was not a global village in terms of advancement in information Technology and the methods use for selecting risk assets are also limited. Unlike now where use of sophisticated computer softwares are employed to select an asset for investment.

The theory of Fama and Miller (1972) states that shareholders fund increases because of investing in higher risk assets. The leased assets with higher risk therefore increases shareholders fund and vice – versa.

The theory was based on an environment, which may not have similar characteristics with Nigerian environment. In line with these theories, the study theorized that there is direct relationship between size of leased assets used by banks and profitability. This lends support to the theory of Igbinedion (2006), Edward et al (2006) and Wright (2004). In addition, the study theorises that size of leased assets determines size of shareholders fund and investment. This also lends support to the theories of Jensen and Meckling (1976) and Fama and Miller (1972).

The theory also shows how the size of leased assets of Banks contributes positively to their profitability, investment size and shareholders fund which are measures of performance.

The theory posits that if we control for profitability, investment and shareholders fund, size of leased assets is unrelated to banks performance. Thus, an increase in volume of lease in Banks directly increases profitability, investment and shareholders fund.

In addition, the theory assumes that increase in profit will provide excess funds for investment and with high returns on investment; the shareholders fund is expected to improve.

The question of substitutability or complementarily of leasing and bank loan has been studied in details by the financial literature but without reaching a consensus of unanimous reply. According to Myers *et al*. (1976), the use of leasing would be probably accompanied by a lessor utilization of a bank loan, reducing, in the same proportion, the firm's debt capacity. The validity of such an argument is based on the perfect substitution hypothesis between leasing and bank loan. Therefore, this perfect substitution hypothesis can be rejected in favour of an imperfect substitution and sometimes in favour a complementarily between banking loans and leasing. The first argument against a perfect substitution between leasing and debt concerns the substantial costs borne by the (banking)

creditor or (credit) lessor in case of corporate bankruptcy. For Krishnan and Moyer (1994), costs created by the bankruptcy of the tenant would be lesser for the lessor that for any other creditor. The quality of ownership allows him to recapture the goods in case of corporate bankruptcy when the contract is not stopped. In fact, it avoids opportunity costs associated with the slowness of the resolution process of the bankruptcy and more rapidly may allow to resale the asset.

The second argument contradicting perfect substitutability between leasing and bank loan is based on properties of leasing. By the terms of the contract and rights given the lessor, leasing has characteristics close both to the secured and unsecured bank loan. The secured bank loan, because lessor has a real guarantee in the ownership of asset in the contract; the non-secured bank loan, because unpaid rents prior before bankruptcy has the rank than a banking loan. In most of cases, the funds are lost by the creditor. The diversity of the debts contracted by the firm, introducing a distortion between creditors in case of bankruptcy, favours the thesis of the imperfect substitution leasing/ bank loan.

Although the perfect or imperfect substitutability between leasing and bank loan has been accredited by the financial literature, the work of Lewis and Schallheim (1992) has questioned it. In line with De Angelo and Masulis (1980) - according to them, the debt use by a firm is reduced, if it cannot benefit from substantial fiscal gains on amortizations- the authors take into account this fiscal

dimension to compare leasing and bank loan. They show that leasing allows the firm to transfer fiscal gains on amortizations to lessor (who is the only one actor to have the possibility of amortizing the equipment). Furthermore, theses gains are retroceded back to the lessee by means of a contractual reduction in dues. In the case of financing by leasing, the lack of fiscal advantage on amortizations favours the additional bank loan issuing as a fiscal leverage. Leasing and the bank loan appear then as complements rather than substitutes. Hence, a positive relationship between the use of leasing and the level of corporate loan results from this.

The analysis by Lewis and Schallheim (1992) has not generated empirical verification. The only studies corroborating the complementarity made did so undirected by comparing the leasing rate and the level of corporate loan. Ang and Peterson (1984) on the American market, which was criticized due to the fact of the lack of capacity control of firms' loan in the empirical test, produced the most prominent controversy. Others complementary analyses then corroborated (Finucane, 1988; Adams and Hardwick, 1998 ; Branson, 1995) or not corroborated (Adedeji and Stapleton, 1996 ; Beattie *et al.*, 2000) the complementarity studies between leasing and bank loan. These empirical studies nevertheless agreed on firms' characteristics which to use, most often, leasing. They have more bank loan (or more important gearing), smaller liquidity and more important risk. The question of complementarity or substitutability of bank loan and leasing seems to

be unsolved because there is no consensus between theoretical and empirical approaches. Leasing is often analyzed as a last resort solution, especially for very weak firms. Firms' financing preferences nevertheless depend on the characteristics. It allows lessor to gain a clientele of firms with atypical profiles. The reasons for the choice of leasing versus bank loan can therefore be several, which are discussed in the following studies.

As underlined by Smith and Wakeman (1985): "the coexistence of both leased and purchased assets suggests that the net benefits of leasing are uniformly neither positive or negative ".

In this line of thought understanding the choice of leasing versus bank loan for the firm, would depend on costs/advantages or benefits. Indeed, from an economic viewpoint, leasing can be analyzed as an operation of investment financing, which has the particularity of dissociating the legal ownership of the equipment from its economic ownership. Contrary to a classical credit operation, the lessor remains the owner of the asset during the whole period of the transaction. This security due to asset ownership allows it to be retrieved if there is a payment default by the lessee, so as to resell it or rent it again. The lessor appears, according to Capiez (1992), to be "a creditor who has anticipated all possible changes of its wealth and has beforehand protected himself by the form of the contract in which its retains ownership". A limit in bank loan supply can lead

the firm to increase its use of leasing. Krishnan and Moyer (1994) who consider leasing as “the last financing resort” present this argument in the literature. According to these authors, when the risk of bankruptcy for the firm increases, the unavailability of bank loan obliges it to turn to leasing, because costs due to the latter, in case of failure are smaller than for any other creditor, considering the efficient and real safety whose it benefits.

Lease *et al*. (1990) show in the framework of a study on 137 leasing operations, that the resale value of the equipment in case of default of the lessee represents on average 37.8% of the purchase price of the equipment. Compared to the amount of rent remaining outstanding (estimated at 59% of the value of the equipment), the share taken back by the lessor represents 64% the amount of the financing granted. The authors also show that, on average, the period, between the firm bankruptcy and the time when the lessor recovers his claim in the form of the resale of the equipment, is varying from 1 month to 44 months. The main empirical studies on the question (Krishnan and Moyer, 1994; Sharpe and Nguyen, 1995; Graham *et al.*, 1998) conclude to an increase in resorting to leasing with the increase in the risk of bankruptcy of the firm. Although the conservation of the legal ownership is a protection for the lessor -it allows the firm to carry over the risk of obsolescence to the lender- this advantage will be all the more profitable to the firm, in the case of a new technology is growing up when the contract is

negotiated over a relatively short period. The acquisition of the legal ownership being optional in leasing contract, this formula of financing would seem to be completely adapted when the period of use of the equipment is lower from its economic life duration (Smith and Wakeman, 1995). The firm avoids transaction costs generated by marketing costs useful to resale the equipment, which would explain a greater resorting to leasing by firms.

Though advantages encourage firms to use leasing, the firm can however limit its use and prefer bank loan, because of an operational mobility loss for the firm. Indeed, a firm which is involved in a leasing operation without exploiting an activity during irrevocable period, loses then the ability of spreading set if the activity is no longer profitable or if the sector was affected by a circumstantial major economic shock slowing its activity. That is not the case, when the asset is financed by bank loan. Leasing contracts cannot be cancelled without the agreement of the lessor and generates the payment of early termination penalties. This rigidity in the policy of redeployment of the firm may then limit its use[5].This cost due to the operational flexibility loss will vary according to the firm. Indeed, the large firm possesses an internal redeployment capacity due to the fact of their more diversified activities, and for specific assets that can be the subject of an alternative use. Similarly, for firms in financial distress, the cost due to loss of financial flexibility will be all the heavier as prevents redeployment on more

profitable activities. As our main objective is to understand financing policies by leasing, the literature allowed us to identify two main reasons in the decision of leasing, deriving from analysis supply and demand, its greater availability compared with bank loan and the advantages inherent in the nature of the financing.

2.6 Theoretical Framework

Jensen and Meckling (1976) theorized that risky leased assets directly increases investment size of firms; that with savings made through leasing over outright purchase, there will be fund available to invest.

This theory however addressed the period when the world was not a global village in terms of advancement in information technology and the methods use for selecting risk assets are also limited. Unlike now where use of sophisticated computer softwares are employed to select an asset for investment.

The theory of Fama and Miller (1972) states that shareholders fund increases because of investing in higher risk assets. The leased assets with higher risk therefore increases shareholders fund and vice – versa.

The theory was based on an environment, which may not have similar characteristics with Nigerian environment. In line with these theories, the study theorized that there is direct relationship between size of leased assets used by banks and profitability. This lends support to the theory of Igbinedion (2006),

Edward et al (2006) and Wright (2004). In addition, the study theorises that size of leased assets determines size of shareholders fund and investment. This also lends support to the theories of Jensen and Meckling (1976) and Fama and Miller (1972).

The theory also shows how the size of leased assets of Banks contributes positively to their profitability, investment size and shareholders fund which are measures of performance.

In addition, the theory assumes that increase in profit will provide excess funds for investment and with high returns on investment; the shareholders fund is expected to improve.

According to shareholder fund theory, the goal of the firm is the maximization of the fund of the shareholders. A firm should strive to maximise the return to shareholders, as measured by the sum of capital gains and dividends, for a given level of risk or reduce the risk with the same level of income. According to Kaplan and Norton (1996, 2000, 2004) firms have two basic approaches for increasing the shareholders' fund: revenue growth and productivity. The former generally has two components: build the franchise with revenue from new markets, new products, and new customers; and increase value to existing customers by deepening relationships with them through lease financing activities. The productivity strategy also usually has two parts: improve the company's cost structure by reducing direct and indirect expenses, and use assets more efficiently

by reducing the working and fixed capital needed to support a given level of business.

Lease financing literature research has found that in line with Kaplan and Norton (1996, 2000, 2004), cost reduction and revenue growth are the key elements for firm's performance (Krumm and Vries, 2003). Also Burns (2002) comes to conclusion that the contribution of leasing to the firm's value could be measured where a firm has two financial strategies for driving shareholder fund, profitability and growth.

The theoretical assumption that underpins this work is shareholders fund theory. The theory posits that the goal of the firm is the maximization of the fund of the shareholders. A firm should strive to maximise the return to shareholders, as measured by the sum of capital gains and dividends, for a given level of risk or reduce the risk with the same level of income. According to Kaplan and Norton (1996, 2000, 2004) organizations have two basic approaches for increasing the shareholders' fund: revenue growth and productivity. The former generally has two components: build the franchise with revenue from new markets, new products, and new customers; and increase value to existing customers by deepening relationships with them through lease financing activities. The productivity strategy also usually has two parts: improve the company's cost structure by

reducing direct and indirect expenses, and use assets more efficiently by reducing the working and fixed capital needed to support a given level of business.

The theory posits that if we control for profitability, investment and shareholders fund, size of leased assets is unrelated to banks performance. Thus, an increase in volume of lease in Banks directly increases profitability, investment and shareholders fund. This theory can be represented mathematically as:

FG = Max SF

SF = f (RG, PRD)

RG = ΣS_{t-1} ……S_n _____ (1)

PRD = $\Sigma S_{t_n} - Cost_1$……....n _____ (2)

$\Pi = \Sigma S_t - \Sigma$ Cost…….....n_____ (3)

Π = f (L)

SF = f (L)

INV = f (L)

FG = Firms Goal

SF = Shareholders Fund

RG = Revenue Growth

PRD = Productivity

INV = Investment

2.7 Summary

This chapter discussed the conceptual framework of leasing. It is a means by which profits are generated through the use and not ownership of equipment. An equipment lease is a contract between a Lessor and a Lessee for the lease of a specific piece of equipment selected from a manufacturer or vendor by the Lessee. The Lessor retains ownership of the equipment while the Lessee gets to use the equipment to generate as much profits as possible, but pays only a small portion of the profits generated to cover lease rentals. How a lease is viewed and utilised varies considerably, although there are two major forms of leasing; Finance lease and operating lease.

Lease financing in Nigerian banks is a form of credit facility mainly to corporate customers by which the bank finances the purchase of plant/equipment under different types of leases. All banks are involved in the business of leasing either as lessors, lessee or financier of a leasing transaction.

A great advantage to leasing is that it may be allowed to be "off the balance sheet." This means that leases can be disclosed as balance sheet footnotes. They do not appear as debt even though they represent an ongoing company liability. At present, there is no specific law on the subject of leasing in Nigeria. The practice of leasing is currently governed mainly by the common law and provisions scattered in other laws.

The chapter that follows discusses the methodology of the research. analysis.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The main objective of this study is to determine empirically how lease financing affects the performance of Nigerian banks. In order to achieve the objective above, this study examines the impact of leasing on three variables namely profits, investments and shareholders fund (as proxies for performance).

This chapter explains the research methods and the sources of data. It also presents the population and the sample banks, mode of collection of such data, and techniques of analysis chosen as well as justification of using the methods and the techniques.

The choice of the methodology has been guided by the objectives and the nature of the data required for the study. The methodology adopted consists primarily of a detailed impact of leasing transaction on the performance of Nigerian banks. Consequently, inferences have been drawn regarding the extent of the impact.

In addition to the secondary data that have been collected in the form of financial statements, questionnaires have been administered and interview conducted with two categories of respondents. These are banks` staff ranging from management to senior officers and banks corporate customers who transact with

banks on leasing. The use of questionnaires was considered necessary in order to ascertain the most type of leasing adopted by Nigerian banks and rate their performance. The management and senior officers of the banks are selected because of their role in assessing the parties to transact with. Other categories are the one involved deeply in leasing business with the banks. The customers' questionnaires recipients are selected from list of lessors and lessees supplied by the selected banks since the banks participate as both lessors and lessees or even as financier.

In the sections that follow, an explanation and justification of research methods selected are provided, followed by the description of population and sampling techniques and discussion on the sources of data collection for the study.

3.2 Basic Research Methods and Design

There are various research methods available to researchers; however, the method adopted by a researcher in a particular study depends on the problem and the situation that the researcher is confronted with. Basically, research method deals with the nature of the investigation to be undertaken and these have been classified in terms of three periods of time – past, present and future. The choice of a particular method becomes an important factor in validating the conclusions of any research.

The selection of a primary method of investigation of a given problem is a key consideration for the investigator (Osuala, 1987). There must be thorough knowledge of the basic methods of research to guide the researcher in the choice of a primary research method to be used in solving his problem.

Therefore, for the purpose of this study, both primary and secondary methods of data collection are used.

3.2.1 Descriptive Research

A descriptive method is selected to enable the researcher to analyse records maintained for other than the research purpose. For instance, the financial reports of the sampled banks. According to Osuala (1987) there are three basic ways of securing data for descriptive research; direct observation, indirect observation and analysis of record maintained for other than the research purpose. The selection of descriptive design is equally important for this study since cross-sectional data of five years are studied and analyzed.

In descriptive design, the researcher observes the behaviour of one or more variables all at once (Asika, 1991). This research work therefore studies the behaviour of three variables i.e. Profitability, Investment and Shareholders fund as they relate to leasing in the Nigerian banking industry for the period of five years.

Descriptive research is typically concerned with determining the frequency with which something occurs or the relationship between two or more variables

(Ukpong, 2002). The descriptive research is typically guided by an initial hypothesis. The researcher adopted this method to determine the impact of leasing on three variables; profitability, investment and shareholders fund considering the hypothesis formulated. The study adopts the correlational and the cross-section of time series descriptive research design.

In addition to descriptive research, the study has used the survey method. The study has surveyed the views of management and senior staff of the sampled banks and some selected listed corporate customers of the banks who are either lessors or lessees. The survey was through questionnaire administration and interviews. A clear demarcation between these methods can be drawn on the basis of time series. While the former deals with the past, the latter is concerned with the present. The survey method has been used to gather first hand information on the relevant issues through questionnaires and interviews. The quality of a survey research depends on the sample chosen being a fair representation of the population from which it is selected, and the reliability of the data selected from the sample (Selltiz et al 1976).

The first criterion mentioned by Selltiz et al, (1976) is directly related to the sampling technique used in the study. The sampling technique used in this case identifies those banks with much more volume of leasing value over others in the

population. The second criterion – the reliability of data, is dependent upon the cooperation of the sample respondents.

In order to ensure the reliability of the data collected, effort has been made to elicit the cooperation of the respondents and research assistant was employed to explain to the respondents the questions in the questionnaires.

However, it is believed that the approach used in selecting the methods and the sample of the study enabled us to generalize the findings of the research to the population.

3.2.2 Survey Research

Survey research focuses on the population of the universe. Data are collected from the population for intensive study and analysis. The researcher normally finds that he cannot possibly study all the subjects or items in the population. Hence, the survey researcher selects a sample from, or a subset of the population, using some techniques of sampling in order to discover the relative incidence, distribution and inter-relations of the variables (Mainoma, 2000).

By its nature, survey research deals with the present time and it is oriented towards the determination of other states of a given phenomenon and not necessarily trying to establish the cause and effect relationships. Surveys are generally based on large cross sectional samples. These characteristics distinguish it from other methods such as historical research method and experimental studies.

3.3 Population and Sampling Techniques

The population of this study is 20 banks that are members of Equipment Leasing Association of Nigeria (ELAN) and also quoted on the Nigerian Stock Exchange (NSE). The list of the banks that constitute the population for this study is provided in appendix B.

These banks are expected to have trading records of at least three years, with not less than 25% of shares in the hands of the public and not less than fifty shareholders. The banks are also expected to submit their quarterly, semiannual and annual reports to the Nigerian Stock Exchange.

The population of this study is specifically selected for two reasons:
Firstly, the main objective of the study is to examine the impact of leasing on the performance of Nigerian banks. Thus, the selection of the population concentrates only on banks.

Secondly, all the twenty banks that constitute the population of the study are members of Equipment Leasing Association of Nigeria, which provides confidence of their deep involvement in leasing business.

The sample of the study are five (5) banks drawn from the total of 20 banks indicated above representing 25% of the population for the study. The list of sample banks is provided in appendix C. This has been arrived at using systematic

sampling technique, so that as far as possible most if not all features of the population is represented. The systematic sampling is usually given by:

$$k = \frac{N}{n}$$

Where k is the sampling interval, N is the total number of units in the population and n is the required sample size.

The systematic sampling technique is adopted for this study for the reason that all the 20 banks have an equal chance of fulfilling the following criteria;

i. The banks have leasing transactions and records during the period under study (2001-2005)

ii. Availability of financial reports of atleast five consecutive years covering the period under study (2001-2005).

The rationale behind adopting these criteria is that financial reports provide the variables to be correlated to ascertain whether there is impact of leasing on the performance of Nigeria banks or not. It is on the basis of this information that the impact of leasing on banks' performance either positive or negative will be determined.

3.4 Sources and Methods of Data Collection

The data used in this study have been obtained from secondary and primary sources.

3.4.1 Secondary Sources of Data

Under the secondary source, the data were collected from the published financial statements of the sampled banks covering the period of five (5) years (2001-2005). The period is selected for two reasons. Firstly, this is the period when Nigerian leasing industry experienced tremendous reforms and patronage due to the effort made by the equipment leasing association of Nigeria. The association organises many workshops and seminars to create awareness in the business of leasing in Nigeria. In fact this even leads forwarding a bill on leasing laws to the National Assembly Abuja by ELAN (Olusoga, 2005). Secondly, the economic reforms made it compulsory for the banks to compete for survival which lead to improvement in the value of leasing business in the Nigerian banking sector.

3.4.2 Primary Source of Data

The instruments used to obtain the primary data for this study are questionnaire and interview. The questionnaire is administered to management and senior officers of the banks and corporate listed customers of the banks. This is inform of closed and open ended questionnaires. The closed or fixed questionnaires have fixed number of options. In closed or structured questionnaire spaces are provided for the respondents to fill in short answers ‘YES’ or ‘NO’. On the other hand, the open or unstructured form of questionnaires is adopted when there was a need to enquire why the respondent is giving the type of response. The

major deficiency of fixed response is the potential inability to provide respondent with all relevant response alternatives.

Open- ended questionnaire on the other hand offer less restriction to the respondent in term of possible choice since he /she is free to elaborate his / her opinion in the space provided. One hundred (100) questionnaires were distributed to the sample of the study.

However, the structured interview consisting both Bank staff and customers was adopted for this study in order to enable the researcher gather information in a planned sequence and to limit the time spent in conducting such interview. Not with- standing, the combination of both questionnaire and interview have been used to greatly enhance the process of data collection.

3.5 Techniques of Data Analysis

The common techniques for analysis that are used in research include chi-square, t-test, f-test, regression, correlation coefficient and simple percentage.

However, for the purpose of this research, simple linear regression, t-test and simple percentage have been used. This is because they actually capture and address inter-relationship of the data collected from both primary and secondary sources.

3.6 Justification of Techniques of Data Analysis

The simple percentage is adopted in recognition of the fact that some of the objectives of the study are not amenable to quantifiable measurements. Therefore, the only solution to them is to use simple percentage as a tool of analysis.

The simple linear regression and t-test and are used in testing the formulated hypotheses of the study for the following reasons:

i) They have the advantage of being used to determine the relationship between dependent and independent variables. It explains the level of changes in dependent variables for a given level of changes in the independent variables.

ii) The technique is useful in making prediction because of the linearities that exist between two variables.

3.7 Summary

The chapter has discussed the research method adopted in the study for the purpose of data collection. They are descriptive and survey method. The choice of the methods is informed by the major objectives of the study. The chapter however, has examined briefly the various research methods available and the particular ones adopted.

Considering our desire to ensure greater accuracy, twenty banks that are quoted and members of Equipment Leasing Association of Nigeria (ELAN) are used as population of the study and five selected as representative sample of the study using simple random sampling method. Thus, 25% of 20 banks = 5 banks.

The data needed are historical in nature and they include profits, investments, shareholders fund and leases of the 5 banks in the sample. These are extracted from published financial statements of the selected banks. Also, questionnaire and interview were used to gather data in the form of behavioural responses of the respondents.

For the purpose of data analysis, multiple regression, t-test and f-test are used in testing the formulated hypotheses of the study and simple percentage tool is adopted to complement the tested hypotheses in achieving other qualitative objectives of the study.

The chapter that follows would be devoted to the presentation, analysis and interpretation of the pooled cross-section of time-series data collected for this study.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.1 INTRODUCTION

This chapter presents and discusses the data collected in the course of the research work. The chapter is divided into two main sections. The first section covers the presentation and analysis of secondary data collected from the financial statements of the sampled banks. The hypotheses formulated are tested in this section in order to determine the relationship between dependent variables (Profits, Investments and Shareholders fund) and the independent variable (Leasing). The aim is to find out whether leasing has an impact on profits, investments and shareholders funds of the selected banks.

The second section presents and discusses the responses from the administered questionnaires and interviews. This is necessary because some of the variables of the study are qualitative in nature and cannot be subjected to statistical test. The responses are presented in a tabular form and analysed under each table.

The aggregate values of both dependent and independent variables for the five selected banks and within the period of the study are presented in table 4.1 below:

TABLE 4.1 AGGREGATE VALUES OF DEPENDENTS AND INDEPENDENT VARIABLES

Years	Independent Variable	Dependent Variables		
	X ₦ 000	Y_1 ₦ 000	Y_2 ₦ 000	Y_3 ₦ 000
2001	2,265	11,860	26,095	36,670
2002	3,985	14,640	35,725	48,115
2003	7,160	19,970	27,730	61,280
2004	8,760	22,890	65,845	83,165
2005	4,575	29,005	90,515	164,280

Source: Annual Reports and Financial Statements of Selected Banks (2001-2005)
x = leasing in Naira. y_1=Profits, y_2 = Investments, y_3 = Shareholders Fund,

Simple linear regression has been used to estimate the relation between the dependent variables (Profits, Investments and Shareholders Fund) and the independent variable, which is represented by leasing in Naira. The technique of t-test has also been used to estimate the regression coefficient of the variables.

4.1.2 Determinants of the Impact of Leasing on the Performance of Nigeria Banks.

The study uses three dependent variables for determining the aggregate impact of leasing on the performance of Nigeria banks. These three explanatory variables are profits, investments and shareholders fund. The study hypothesizes significant relationship between explanatory variables and leasing in Naira.

The regression results are presented in Table 4.2 below. The full results are contained in Appendix D.

Table 4.2: Determinants of impact of leasing on the performance of Nigerian banks

Sample Statistics	Dependent Variables		
	Y_1	Y_2	Y_2
Mean	19673.000	49182.000	78702.000
Standard Dev.	6780.442	28108.545	50865.735
Minimum	15629.669	40515.477	68517.844
Maximum	24145.049	58767.445	89965.992
R	0.501	0.259	0.168
R^2	0.251	0.067	0.028
t- values	1.662	0.969	0.938
Constant	12660.103	34150.469	61038.234
B	1.311	2.810	3.302
Significant	0.195	0.404	0.418

Source: SPSS Printout of Simple Regression computed from table 4.1 above.

4.2 Impact of Leasing on Profitability of Nigerian Banks.

A null hypothesis that leasing has no significant impact on the profitability of Nigerian banks was formulated to ascertain whether leasing has impact on profit of Nigerian banks or not. The hypothesis is tested and the regression result in table 4.2 reveals a positive correlation of 50.1% percent between leasing and profitability. The correlation coefficient, r = 0.50 despite positive but is not still significant because the critical value of the correlation at 5% level of significant is 0.88 which is higher than the calculated value. This shows that between pair of leasing and profitability there is no significant relationship. Also, it corroborates the result of the regression model that leasing is not playing a significant role in measuring profitability and the positive nature of the correlation coefficient explains the model in the regression $y_1 = \partial + \beta x$ .The result of the model reveals

that for every ₦ 1 naira increase in leasing brings about ₦1.31k increase in profitability. While the coefficient of determination (R^2) shows that leasing occupies 25% of the value of profitability. That is other contributors covered the remaining 75%.

In addition, t-values in the regression results (see table 4.2) indicate that profitability has the highest value of 1.662 compared to those of investment and shareholders fund. This shows that leasing has greatest impact on the profitability than investment and shareholders fund. This can also be confirmed by lowest mean and standard deviation values. The average value for profitability in the table is 19,673 which is lower than that of investment (49,182) and shareholders fund (78,702). This implies that profitability receives the highest impact followed by investment and then shareholders fund. In addition, the variable with smaller standard deviation believed to have a greater impact from leasing, Esan and Okafor (1995). While, profitability happened to have the lowest standard deviation of 6,780.442.

However, the calculated t-values of profitability 1.662 (see table 4.2) is less than the t-critical value 12.706 at 5% level of significant (P>0.05). This therefore produced the evidence of accepting the null hypothesis that leasing has no significant impact on profitability of Nigerian banks.

4.3 Impact of Leasing on the Investment of Nigerian Banks.

A null hypothesis that leasing has no significant impact on the investment of Nigerian banks was formulated to ascertain whether leasing has impact on profit of Nigerian banks or not. The hypothesis is tested and the regression result in table 4.2 reveals a positive correlation of 25.9% percent between leasing and investment. The correlation coefficient, r = 0.26 despite positive but is not still significant because the critical value of the correlation at 5% level of significant is 0.88 which is higher than the calculated value. This shows that between pair of leasing and investment there is no significant relationship. Also, it corroborates the result of the regression model that leasing is not playing a significant role in measuring investment and the positive nature of the correlation coefficient explains the model in the regression $y_2 = \partial + \beta x$ .The result of the model reveals that for every ₦ 1 naira increase in leasing brings about ₦2.81k increase in investment. While the coefficient of determination (R^2) shows that leasing occupies only 6.7% of the value of investment. That is other contributors covered the remaining 93.3%.

In addition, t-values in the regression results (see table 4.2) indicate that investment has the value of 0.969. This shows that leasing has positive impact on investment but less than that of profitability while higher than that of shareholders fund. The mean value for investment in the table is (49,182) which is lower than that of shareholders fund but greater than profitability's value. This implies that

investment receives more impact from leasing than shareholders fund but less than that of profitability.

However, the calculated t-values of investment 0.969 (see table 4.2) is less than the tabulated t-value 12.706 at 5% level of significance. This produced the evidence of accepting the null hypothesis that leasing has no significant impact on investment of Nigerian banks.

4.4 Impact of Leasing on the Shareholders Fund of Nigerian Banks.

A null hypothesis that leasing has no significant impact on the shareholders fund of Nigerian banks was formulated to ascertain whether leasing has impact on profit of Nigerian banks or not. The hypothesis is tested and the regression result in table 4.2 reveals a positive correlation of 25.9% percent between leasing and shareholders fund. The correlation coefficient, r = 0.26 despite positive but is not still significant because the critical value of the correlation at 5% level of significant is 0.88 which is higher than the calculated value. This shows that between pair of leasing and shareholders fund there is no significant relationship. Also, it corroborates the result of the regression model that leasing is not playing a significant role in measuring shareholders fund and the positive nature of the correlation coefficient explains the model in the regression $y_3 = \partial + \beta x$ .The result of the model reveals that for every ₦ 1 naira increase in leasing brings about ₦3.30k increase in shareholders fund. While the coefficient of determination (R^2)

shows that leasing occupies only 2.8% of the value of shareholders fund while other contributors covered the remaining 97.2%.

In addition, t-values in the regression results (see table 4.2) indicate that shareholders fund has the value of 0.938. This shows that leasing has positive impact on shareholders fund but less than that of profitability and investment. The mean value for the shareholders fund in the table is (78,702) which is greater than that of both shareholders fund and investment's value. This implies that shareholders fund receives less impact from leasing than both investment and profitability.

However, the calculated t-values of 0.938 (see table 4.2) is less than the tabulated t-value 12.706 at 5% level of significance. This produced the evidence of accepting the null hypothesis that leasing has no significant impact on investment of Nigerian banks.

4.5 Performance Appraisal of Nigerian Banks

To appraise the performance of Nigerian banks for the purpose of this study, the performance indicators of the sample banks; Profit after tax, Shareholders' funds and Investment are assessed and analyzed.

The following table contains performance indicators values of the sampled banks for the period of the study 2001-2005.

Table 4.5: Performance Appraisal of Nigerian Banks

Years PI	Banks				
	First Bank ₦'m	Oceanic Bank ₦'m	Guaranty Trust Bank ₦'m	Zenith Bank ₦'m	Afri Bank ₦'m
2001					
X_1	5,066	1,690	1,504	2,418	1,181
X_2	279	1,064	5,706	26	19,021
X_3	18,170	4,086	4,134	6,726	4,554
2002					
X_1	4,776	1,478	3,081	3,504	1,801
X_2	2,668	7,091	10,589	360	15,015
X_3	19,406	5,185	8,016	9,306	6,203
2003					
X_1	11,010	338	3,211	4,424	988
X_2	2,952	1,099	6,530	721	16,429
X_3	27,006	4,993	9,661	12,652	6,969
2004					
X_1	17,458	833	4,056	5,191	1,328
X_2	11,483	1,369	24,115	4,427	18,476
X_3	41,605	6,520	11,618	15,675	7,748
2005					
X_1	13,234	2,527	5,434	7,156	652
X_2	21,651	1,753	32,333	6,139	28,639
X_3	48,726	20,710	33,643	37,790	23,362

Source: Values of performance indicators extracted from financial statements of sampled banks.
X_1 = Profit, X_2 = Investment and X_3 = Shareholders Fund

In Table 4.5 above, First Bank PLC realizes highest profit, and then followed by Zenith Bank in 2001 - 2005. In addition, none of the selected Banks experienced loss within the period of the study. This implies that the Nigerian Banks are tremendously performing from the profitability perspective. This may be because of competitive nature of the Banking sector.

In terms of investment, Afri Bank had the highest investment followed by Guarantee Trust Bank in 2001, 2002 and 2003. In 2004 and 2005 however, Guarantee Trust Bank had the highest investment followed by Afri Bank. Table 4.5 shows a continuous increase of investment values in First Bank and Zenith Bank from 2001 – 2005. While Oceanic Bank experienced a fall of 85% from 2002 to 2003. This is because of drastic fall in the profit value of the bank in 2002 to 2003. The bank may not have enough funds to finance its investment and improve its returns. Guarantee Trust too experienced almost the same except in 2003 and Afri bank in 2002.

It is important to note that all the banks are involved in investment in one way or the other as shown in their financial statements. This implies that investment plays a dominant role in determining the performance of Nigerian Banks.

Furthermore, Table 4.5 shows an improvement in shareholders fund in all the banks within the period of the study except Oceanic and Guarantee Trust banks in 2003. Despite a very challenging operating environment in the banking sector, banks have performed remarkably well.

The year 2002 witnessed a keen competition within the banking industry. During the year, banks recorded a very impressive and positive growth in every line and in all the indices of performance measurement. This may be as a result of

improvement in economic indices such as exchange rate stabilization, Gross domestic product and National Income. For instance, Guaranty Trust Bank reported an increase of 59% in Gross earnings, 55% in Profit after tax, 51% and 101% in net asset and shareholders fund respectively.

In the year 2003, Afri-Bank plc witnessed a decline in Gross earnings from N15.15b to N13.82b representing 9% and 46% profit after tax. Other performance indices such as Net assets, shareholders fund and investment appreciated by 17% 15% and 9%. All performance appraisal parameters increased in the case of the other banks.

The Marco-economic policies of the government in 2004 were essentially directed at achieving sustainable economic growth and containing inflation within the single range while minimizing exchange rate volatility. The lunching of the national economic empowerment and development strategy (NEEDS), together with its state equivalents (SEEDS) and LEEDS for local governments resulted in high multiplier effect on the economy and in particular for the poor and low-income group. This development increased deposit in Nigerian banks, which resulted in improving their gross earnings and assets. It also gave the banks an opportunity to invest the funds and improve shareholders fund. In the same year, 2004, most of the banks generated investments from stock exchange market. For instance, First Bank of Nigeria Plc issued 7.6 billion shares, Zenith Bank Plc 6

billion shares, Union Bank of Nigeria Plc 4.4 billion shares, Guaranty Trust Bank Plc 6 billion shares, Oceanic plc 6 billion, while Intercontinental and UBA Banks Plc 3.6 and 3 billion shares respectively.

Finally, the year 2005, witnessed a lot of reforms and challenges in the Nigerian banking sector. Some of these reforms are upward review of banks capitalization from N2 billion to N25 billion. This resulted in decrease in the number of banks from 89 to 25 with 13 not able to meet up with the date line of 31st December, 2005. The operating result of most of the banks improved as a result of a competive economic environment to survive; the performance of First Bank Plc in 2005 financial year compared favourably with industry average, with gross earnings of N49.5 billion, which represents an increase of 9.76% over the previous year. Also profit after tax increased by 9.91%, which resulted an increase of 5k on dividend, paid to shareholders. Zenith Bank Plc on the other hand experienced an increase of 46% in gross earnings, 43% in profit, 78% in total deposits, 141% in shareholders fund and 72% in total assets. Others banks such as Oceanic Bank, Guaranty Trust Bank and Afri Bank all performed credibility during the year.

In order to further corroborate the above information, question 3 in the questionnaire required the respondents to rate the performance of their banks within the last 5 years. The responses are presented in table 4.6 below.

Table 4.6: How do you rate the performance of your bank in the last 5 years?

Responses	Respondents	Percentage (%)
Very Good	95	95
Fair	5	5
Bad	0	0
Total	**100**	**100**

Source: Data obtained from field survey in 2007.

From the above table, 95% of the respondents are of the opinion that banks have significantly improved their performance in the last five years, while the remaining 5% indicated a fair performance. This result has corroborated the analysis made on the data extracted from the financial reports of the banks.

4.6 Discussion of Findings

Banks engage in leasing to increase their turn over which ultimately improves their performance. The study accepts the null hypotheses that leasing in Nigerian banks has no significant impact on the three explanatory variables: profitability, investment and shareholders' fund. The results reveal a positive relationship of 50.1%, 25.9% and 16.8% between the value of leasing and profitability, investment and shareholders fund of Nigerian banks respectively. Although the relationships are not statistically significant, there is an increase in the value of proxies of performance (profitability, investment and shareholders fund). The study shows that for every ₦ 1 naira increase in leasing, the volume of profit increases by ₦1.31k, investment by ₦2.81k and shareholder's fund by ₦3.30k in

Nigerian Banks. This result supports the findings of Igbinedion (2006), Wright (2004) and Olusoga (2006).

The result implies that the more banks engage in leasing business, the more profit they make; the more funds are available for investment, and the higher the shareholders' funds. This is because of the potentiality of lease rentals to increase turnover where the bank acts as a lessor and reducing cost because of outright purchase and tax advantage as well as the maintenance cost where the bank acts as a lessee. Also, if a bank participates as financier of a leasing business, interest on the money invested increases turnover that improves the banks' profit, investment and shareholders fund.

The study reveals that the performance indicators of the sampled banks can be explained by the influence of leasing business. In addition, Nigerian banks performed remarkably well within the period of the study. Leasing has no significant impact on profitability, investment and shareholders fund but it increases them, which implies that the performance of Nigerian Banks increases because of increase in their naira value of leasing.

The study also reveals that the more banks lease in building and other assets instead of buying or building them, the better in saving operating and maintenance cost which increases turnover. This supports the study of Oluwude (2002) and Oluyinka (2006).

The study also establishes that there is no specific law on the business of leasing in Nigeria. It is currently governed by the provisions of common law, Companies and Income Tax and Companies and Allied Matters Act. This confirms the findings of Olakunle (2006).

The study reveals low turnover in the Nigerian leasing industry compared to other African countries like Egypt and South Africa. This is because of low level of participation in leasing business in Nigeria. This supports the findings of Olusoga (2006) and Oluyinka (2006).

Furthermore, finance lease is identified as the most common type of leasing undertaken by banks in Nigeria. This leans supports the findings of Igbinedion (2006).

Finally, the study reveals that most of the problems of rental default by lessees to the banks is because of laxity in screening lessees and adhering to the requirements stipulated by banks. This may be as result of favouring those lessees that are not qualified because of their relationship with the banks' officials especially top management. This confirms the findings of Wright (2003) and Kaplan et at (2000).

Chapter Five

Summary, Conclusions and Recommendations

5.1 Summary

This study investigates the impact of leasing on the performance of Nigerian banks. The problem of the study therefore emanated from atleast two reasons:

First, leasing has become a global alternative method of business financing and Nigerian banks are deeply involved in it that makes the study significantly relevant.

Second, studies have been carried out on the impact of leasing on manufacturing firms and small and medium scale enterprises in Nigeria and all the results revealed positive impact on their performance. Iginedion, (2006) studied the leasing impact on the profitability of manufacturing firms and Wright, (2004) on the financing of small and medium scale enterprises. This infact motivated us to find out whether it will be the same or different in the Nigerian banks.

In view of the above, the study hypothesized a significant relationship between leasing and three performance indicators of Nigerian banks namely; profit, investments and shareholders fund.

The findings of the research are based on the result of the tested hypotheses and responses from administered questionnaires and interview. It is also based on the pooled cross-section of time series data collected for the period 2001 to 2005

from a sample of 5 banks out of 20 who are quoted in the Nigerian stock exchange and members of Equipment Leasing Association of Nigeria (ELAN).

Simple linear regression was used for testing hypotheses and simple percentage for analyzing questionnaires. The result of the study reveals that leasing has no significant impact on the performance of banks in Nigeria though the relationship between leasing and all the proxies of performance is established positive.

5.2 Conclusions

In accordance with the research finding that leasing explain the variables of banks performance, the study concludes as follows.

Firstly, both empirical and statistical evidence on the impact of leasing on the three performance indicators namely profitability, investment and shareholders fund in the Nigerian banks have no significant impact on the banks' performance despite the relationship between leasing and the performance is positive.

Secondly, the study also concludes that Nigerian banks have performed remarkably well within the period of the study 2001-2005. This may be because of new reforms in the banking sector by the regulating agencies especially Central Bank of Nigeria.

Finally, the study represents a pioneering attempt in assessing the impact of leasing on the performance of Nigerian banks looking at performance from the perspective of profitability, investment and shareholders fund.

5.3 Recommendations

In line with the findings of this study, which reveal that leasing has no significant impact on the performance of Nigerian banks and the conclusions drawn by the study, the following recommendations are offered to strengthen and improve leasing business in Nigeria banks.

1. The management of Nigerian banks should work very hard to improve the business of leasing in their banks in order to increase the volume of proceeds accruable from leasing business. They can do that through creating a unit or section that exclusively deals with leasing transactions and follow it up vigorously with series of advertisements. The banks shareholders should encourage the management to engage in greater business of leasing. This has the potentials of improving earnings and shareholders' funds.

2 The Management of Nigerian banks should increase their commitments into leasing business to improve earnings from the proceeds of leasing. They should emphasize the leasing of buildings and office equipment instead of building and buying them at the event of expansion or opening of new branch. This will solve the problem of abandonment of building and equipment because of distress. Some

of the victims of this are Savannah Bank Plc, African International Bank Plc, City Bank Plc etc.

3. The Management of Nigerian banks should strictly adopt and follow the requirements of leasing as stipulated by their policies instead of discriminating and favoring those with connections to the top banks executives. This will reduce if not eliminate the problems of default of lease rental payments because of incompetence.

4. The process of establishing a specialsed legal framework for the practice of leasing should be comprehensive not only in terms of problem solving but also in terms of the provision of adequate laws by government especially the judiciary as regulating agency. Given the high rate of default that characterized most markets and numerous difficulties attendant on repossession, there is an urgent need for a leasing Act to be enacted by National Assembly for easy and speedy repossession of leased asset. As obtained in developed countries, lessors should be permitted to recover the equipment once they have documentary evidence of title (lease agreement, title document etc) and proof that they have notified the lessee of a default. This can be achieved by ex parte motion, as full court proceedings could become prolonged. In return, the lessors should be expected to enter into an undertaking to cover damages if repossession has been found to be improper.

5. The Management of Nigerian banks should solicit and follow up from federal government, the provision of adequate fiscal incentives such as review of tax incentives on leasing to encourage investment in the industry. This should be by way of tax holiday, as in Egypt where leasing companies currently enjoy a five-year tax holiday or in Ghana where interest income generated by the banks from lending to a leasing company is taxed at 20% instead of the normal rate of 32.5%. Similarly, leasing transactions should be exempted from taxes that appear to impose punitive tax measures on lessors. In Nigeria, these measures include subjecting leasing to Value Added Tax (VAT), which amounts to double taxation as VAT is paid on the leased asset at the time of purchase and at the time the asset is leased out. The imposition of tax on both income and principal elements instead of income only, is another area of concern.

6. The Federal Ministry of Commerce and Industries should sanitize the leasing industry, which Nigerian banks are participants by the licensing of lessors. This will allow for effective monitoring of lessors' activities and maintenance of standard of good practice in the industry.

7. The Government through legislative arm should make it clear provision in the law exempting leased property from being taken as lessees' property in the event of bankruptcy so that the lessors do not suffer unjustly.

8. The Management of Nigerian banks should collaborate with Equipment Leasing Association of Nigeria (ELAN) in organizing workshops and seminars on leasing activities in the country in order to create awareness on leasing business. This will increase the number of participants in leasing, which in turn increase income derivable from leasing business in Nigerian Banks and their general performance.