

# Equipment Leasing as an Alternative Means of Financing Small and Medium Enterprises in Delta State, Nigeria

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## ABSTRACT

*This study was carried out to investigate equipment leasing as an alternative means of financing small and medium scale enterprises. Although, leasing is anchored on the business philosophy that profits are earned through the use – rather than the ownership of equipment and asset, yet, many operators of small and medium scale enterprises are yet to maximize their potentials. A set of structured questionnaire was used as the instrument for data collection and administered to 100 operators of small and medium enterprises in Delta State, Nigeria randomly selected from the population 95% confidence level. Data analysis was made and the hypothesis formulated was tested using the Pearson Moment Correlation Coefficient at 0.05 level of significance. The study revealed that many operators of small and medium enterprise do not assess lease option and that affect their overall performance. The researcher concluded that equipment leasing has a significant effect on the profitability of small and medium enterprises and recommended that leasing companies should improve their rates by reducing rents on leasable equipment so that owners of small and medium scale business can benefit more from this form of finance option.*

**Keywords:** *Lease option, Small and Medium Scale Enterprise, Finance, Economy*

## INTRODUCTION

It is unquestionably true that the development of a nation's industrial sector hinges greatly on the development of small and medium – scale enterprises operating in that economy. This is because small and medium scale enterprises are significantly yielding the fruits of development particularly employment, utilization of local resources and lower cost provision of inputs and (Olatunji and Sarat, 2014). As proffered in Akpokerere (2009), Small and Medium Scale Enterprises (SMEs) have served as vehicle for rapid industrialization, sustainable development, poverty alleviation and employment generation in many countries. It is for this reason that the role of SMEs in developing emerging economies has assumed a major significance in recent years. As the changing world economy calls for more articulate policies, government has designed means such as equipment and other programmes of support for small and medium scale business enterprises growth and development. Small and medium enterprises like other organizations however exist in a competitive environment and they must continuously seek ways to take lead in their business activities. Besides, the quest for good financial management strategy is not contestable because every business needs a good and dependable cash flow to grow and this has necessitated business owners to seek for ways of reducing cost of operations especially when it comes to asset acquisition

(Akinbola and Otokiti, 2012). Osaze (1993) defines leasing as a contract between the owner of an asset, the lessor and the prospective user of that asset, the lessee, giving the lessee possession and use of the asset on payment of rentals over a period of time. The lessor retains ownership of the asset so that it never becomes the property of the lessee or any third party during the tenure of the lease. Although leasing assist in accessing the much needed assets required for production that would arouse economic development yet many businesses including small and medium enterprises do not tap the enormous opportunities. Small and medium scale enterprises suffer for many constraints such as inadequate finance, marketing problems, and shortage of raw materials, inappropriate technology and production, inadequate infrastructural facilities, labour and inadequate management expenses. Leasing which appears to be a viable financing alternative because it is anchored on the business philosophy that profits are earned from the use – rather than the ownership of equipment and assets are ignored. The broad objective of the study is to investigate equipment leasing as alternative means of financing small and medium enterprises in Delta State. The specific objectives include:

1. To examine if leasing option plays a significant role in profitability of small and medium scale enterprises.
2. To ascertain whether there is a relationship between small and medium enterprises poor leasing attitudes and their finding

For the purpose of the study the following hypothetical statement are considered relevant:

- H<sub>0</sub>1 There is no significant effect between lease option and the profitability of small and medium scale enterprises.
- H<sub>0</sub>2 There is no significant effect between small and medium enterprises poor leasing attitudes and their findings.

## **THE CONCEPT OF SMALL AND MEDIUM SCALE ENTERPRISES**

Though several attempts have been made to define small business, yet the more the attempt the more it is revealed that there is no universally accepted definition that could include the diversity and variety of small scale enterprises. Thus definitions are based on a number of criteria which vary from one society to another (Olannye and Oyibo, 2002). A survey of existing literature on this subject indicates the following as mostly used criteria for the definition of small scale business:

### ***Ownership Structure***

- a) Number of employees
- b) Initial capital outlay (venture capital).
- c) Nature of business.
- d) Technology employed.

At the 13th council meeting of the National Council on Industry held in July, 2001, Micro, Small and Medium Enterprises (MSMEs) were defined by the council as follows:

***Micro/Cottage Industry:*** An industry with a labour size of not more than 10 workers, or total cost of not more than N1.5million, including working capital but excluding cost of land.

**Small-Scale Industry:** An industry with a labour size of 11 – 100 workers or a total cost of not more than N1.50 million, including working capital but excluding cost of land.

**Medium Scale Industry:** An industry with a labour size of between 101 – 300 workers or a total cost of over N50 million but not more than N200 million, including working capital but excluding cost of land.

**Large Scale:** An industry with a labour size of over 300 workers or a total cost of over N200 million, including working capital but excluding cost of land.

According to Adidu (2006), small and medium scale enterprises are generally characterized by the following: (i) Personal commitment of the proprietors whose life saving usually form the bulk of the startup capital; (ii) low initial capital requirement; (iii) ease of entry and exit; (iv) simple technology; (v) high content of local inputs in the production process; (vi) high potential for employment opportunities; (vii) lack of management skills; and (viii) high potential for foreign exchange earnings through export.

Aborode (2007) listed the benefits of small and medium enterprises to include; provision of an effective means of stimulating indigenous entrepreneurship; creating greater employment opportunities per unit of capital invested and aid the development of local technology; through their wide dispersal, they provide an effective means of mitigating rural/urban migration and resource utilization; by producing intermediate products for use in large scale enterprises, they contribute to the strengthening of industrial inter-linkages; they also retain a competitive advantage over large enterprises by serving dispersed local markets and produce various goods with low scale economies for niche markets; and they also serve as a veritable means of mobilizing and utilizing of domestic savings as well as increased efficiency through cost reduction and greater flexibility.

### **The Problem of Small and Medium Scale Enterprises (SMEs) in Nigeria**

Small and medium scale enterprises suffer from a lot of problems which make the realization of the benefits of SMEs difficult in the Nigerian economy. Iromaka (2006) states that the most important problems of SMEs include the following:

**Constrained Access to Money and Capital Market:** Most SMEs are restricted to funds from family members and friends and are therefore unable to respond timely to unanticipated challenges. More worrisome is the SMEs inability to adequately tap available finance from the capital market. This has been attributed to their aversion to disclosure and ownership dilution.

**Lack of Continuity:** Most small-scale establishments are sole proprietorships and such establishments often cease to function as soon as the owner loses interest or dies. This raises the risk of financing such establishment.

**Poor Management Expertise:** Management has always been a problem in this sector as most entrepreneurs do not have the required management expertise to carry them through once the business starts growing. The situation gets compounded as training is not usually accorded priority in such establishments.

**Inadequate Information Base:** Small scale industries are usually characterized by poor records keeping and that usually starves them of necessary information required for planning and management purposes. This usually affects the realization of this sector.

**Poor Accounting System:** The accounting system of most small scale industries lack standards and does not make room for the assessment of their performances. That creates opportunity for mismanagement, which subsequently may lead to enterprises failure.

**Unstable Policy Environment:** Government's policy instability has not been helpful to small scale industries. That has been destabilizing and has indeed sent many small scale industries to early fold ups.

**Restricted Market Access:** Insufficient demand for the products of the SMEs also imposes constraint on their growth. Although many SMEs produce some inputs for the large enterprises, the non-standardization of their products, the problem of quality assurance as well as generally low purchasing power, arising from consumers' dwindling real incomes, effectively restrict their markets. This is further compounded by the absence of knowledge about the existence of fringe markets by the SMEs.

### **Concept of Leasing**

The property covered in a lease is usually real estate or equipment such as an automobile or machinery. There are two main kinds of leases. A capital lease is long-term and ownership of the asset transfers to the lessee at the end of the lease. An operating lease. On the other hand, is short term and the lessor retains all rights of ownership at all times. An agreement that permits one party (the lessee) to use property owned by another party (the lessor). The lease, which may be written either for a short term or for a long term, often results in tax benefits to both parties". Once a lease is signed, its terms, such as the rent, cannot be changed unless both parties agree. A lease is usually legally binding, which means you are held to its terms until it expires. If you break a lease, you could be held liable in court. An oral or written agreement transferring the right to exclusive use and possession of property for some period of time. Some important lease concepts are

- The normal requirement that all contracts having to do with real estate must be in writing does not apply to contracts that are capable of performance in one year or less. In most states, an oral lease for less than one year is enforceable; an oral lease for a longer period is not.
- A tenant is not relieved of responsibility to pay rent if the premises are damaged, destroyed, or partially or totally unusable unless the lease allows it, or unless consumer protection laws applicable to residential leases allow it.
- If a tenant transfers the entire remaining term of a lease to someone else, that is an assignment. If a tenant transfers less than the remaining term, that is a sublease. Either way, the original tenant is still fully responsible for complying with all lease terms, even if the new one does not. In most states, a landlord may require its approval before assignment or subletting, but may not unreasonably withhold its approval.
- A tenant's interest under a lease may be insured, in addition to coverage for the contents. The interest may also be mortgaged, although that would be extremely unusual except in the case of valuable improvements built on leased land under a long-term lease".

## **Types of Leasing Arrangement in Nigeria**

Financial leasing is an alternative to bank loan financing for equipment purchases. The lessor buys the equipment chosen by the lessee, who then uses it for a significant period of its useful life. Financial leases are also called full-payout leases because payments during the lease term amortize the lessor's total purchase costs (residual value is typically between 0% - 5% of original acquisition price), cover his interest costs and provide him profit. The lessee carries the risk of obsolescence, and costs of maintaining the asset in good working condition and insuring it. The lessee typically has the right to purchase the asset at the end of the lease contract for a nominal fee.

Hire purchase is a hybrid instrument also providing an alternative to bank financing for the purchase of equipment. The instrument is typically used for retail or individual financing of motorcycles, sewing machines, refrigerators, and other small ticket items. The lessee tenders a higher down payment (sometimes up to 30% of the purchase price) and, with each lease payment an increasingly higher percentage of ownership is transferred to the lessee, thus building up equity. Ownership transfer is automatic once all required payments are made. Compared to a financial lease, this arrangement is judicially less secure for the lessor because the lessee is part owner of the asset. On the other hand, lessees have a sufficiently large stake in the equipment being acquired, to avoid the risk of losing that stake through default. An operating lease is not a means to finance equipment from multiple, serial rentals and the final sale of the asset. The leasing companies incur the costs of maintaining the leased assets.

## **METHOD**

This study made use of the survey design. The data used in the study were obtained from both primary and secondary sources of data. The instrument of primary data collected was through the questionnaire and face-to-face interview. The questionnaire was pre-tested before use to suit the respondents' level of understanding. A 5 point Likert type scale was used with the following response categories.

Strongly Agree (SA)	=	5 points
Agree (A)	=	4 points
Undecided (UD)	=	3 points
Strongly Disagree (SD)	=	2 points
Disagree (D)	=	1 points

The target population is made up of all owners of small and medium scale-enterprises in Delta State. The number is somewhat infinite. The researcher decided to limit the target population to only owners of small and medium enterprises involved in productive ventures in Ozoro, Oleh and Kwale. A sample of 100 respondents was randomly selected. Data collected were collated, presented on tables and analyzed using percentage. The tables presented contain the analytical details relating to the findings from the respondents. In addition, the hypotheses formulated were tested using the Pearson Production Moments Correlation Coefficient at 0.05% level of significance.

## RESULTS AND DISCUSSION

The results on table 2 show the calculation of Pearson Product Moment Correlation Coefficient on the relationship between lease option and profitability of small and medium scale enterprises. The analysis shows that there is a positive and significant relationship between lease option and the profitability of small and medium scale enterprises. But there is a greater need to test further in order to justify the stated hypothesis. The table shows that the calculated value is greater than the critical value. Therefore the hypothesis that there is no significant relationship between lease option and the profitability of small and medium scale enterprises is rejected. This finding was supported by the study carried out by Akinbola and Otokiti (2012). According to them for every 100% change in organizational profitability, lease option contributed 39.9%.

From the analysis on table 3, the result implies that there is significant relationship between small and medium enterprises poor leasing attitudes and their findings. But there is also the need to test further so as to justify the stated hypothesis. In doing so, test of significance is employed. The null hypothesis that there is no significant relationship between small and medium enterprises' poor leasing attitudes and their profitability is rejected. This implies that there is significant relationship between small and medium enterprises poor leasing attitudes and their profitability. This finding was supported by Olatuji and Sarat (2014) who state that positive relationship exists between small and medium scale enterprises' poor leasing attitudes and their findings. The study observes that the awareness level of operators of SMS enterprises about lease options is still relatively low in the study area. Many entrepreneurs do not assess lease option and that invariably affects their overall performance and in most cases affects the continuous existence of such businesses. The study also reveals that leasing is anchored on the philosophy that profits are earned through the use – rather than the ownership of equipment and assets.

**Table 1:** Types of Businesses by Owners of Small and Medium Scale Enterprises

S/N	Types of Entrepreneurship	No of Owners of Small and Medium Scale Enterprises
1	Bakery industry	14
2	Barbing saloon	16
3	Block industry	13
4	Computer assembly and repairs	9
5	Fashion design/Tailoring	12
6	Furniture/Carpentry	10
7	Laundry/Dry cleaning	8
8	Medium clinic/Hospital services	11
9	Photography	13
10	Shoe making	7
11	Super market/Gift shop	15
12	Welding and Fabrication	6
	<b>Total</b>	<b>134</b>

*Source:* Survey, 2014

**Table 2:** Calculation of Pearson Product Moment Correlation Coefficient on the relationship between lease option and profitability of small and medium scale enterprises.

Options	X Points	Y Responses	XY	X <sup>2</sup>	Y <sup>2</sup>
Strongly agree	5	41	205	25	1681
Agree	4	31	124	16	961
Undecided	3	16	48	9	256
Strongly disagree	2	8	16	4	64
Disagree	1	4	4	1	16
<b>Total</b>	<b>15</b>	<b>100</b>	<b>397</b>	<b>55</b>	<b>2978</b>

$$r = \frac{N \sum XY - \sum X \sum Y}{\sqrt{[N \sum X^2 (\sum X)^2 - N \sum Y^2 - (\sum Y^2)]}}$$

$$r = \frac{5(397) - (15)(100)}{\sqrt{(5 \times 55) - (15)^2 (5 \times 2978) - (100)^2}}$$

$$r = \frac{1985 - 1500}{\sqrt{(275 - 225)(14890 - 10000)}} = \frac{485}{\sqrt{50 \times 4890}} = \frac{485}{\sqrt{244500}}$$

$$= \frac{485}{494.46} \quad r = 0.9808$$

$$T_{cal} = \frac{r}{\sqrt{\frac{1-r^2}{n-2}}}$$

$$= \frac{0.9808}{\sqrt{\frac{1-0.9808^2}{5-2}}}$$

$$= \frac{0.9808}{\sqrt{\frac{1-0.96196}{3}}}$$

$$T_{cal} = 8.7100$$

$$T_{tab} = n - 2, \alpha 0.05 = 5 - 2, \alpha 0.05 = 3 \text{ a } 0.05$$

$$T_{tab} = 2.35$$

**Table 3:** Calculation of Pearson Product Moment Correlation Coefficient on the relationship between small and medium enterprises poor leasing attitudes and their profitability.

Options	X Points	Y Responses	XY	X <sup>2</sup>	Y <sup>2</sup>
Strongly agree	5	43	215	25	1849
Agree	4	28	112	15	784
Undecided	3	14	42	9	196
Strongly Disagree	2	9	18	4	81
Disagree	1	6	6	1	36
<b>Total</b>	<b>15</b>	<b>100</b>	<b>393</b>	<b>55</b>	<b>2946</b>

**Source:** Field Survey, 2014

$$\sum X = 15, \sum Y = 100, \sum XY = 393, \sum X^2 = 55, \sum Y^2 = 2946$$

$$r = \frac{5(393) - (15)(100)}{\sqrt{(5 \times 55) - (15)^2(5 \times 2946) - (100)^2}}$$

$$r = \frac{1965 - 1500}{\sqrt{(275 - 225)(14730 - 10000)}}$$

$$T_{cal} = \frac{r}{\sqrt{\frac{1-r^2}{n-2}}}$$

$$= \frac{0.95617}{\sqrt{\frac{1-0.9617^2}{5-2}}}$$

$$T_{cal} = 7.9016$$

$$T_{tab} = n - 2, \alpha = 0.05 = 5 - 2, \alpha = 0.05 = 3 \text{ a } 0.05$$

$$\therefore T_{tab} = 2.35$$

## CONCLUSION AND RECOMMENDATIONS

The study examined equipment leasing as an alternative means of financing small and medium scale enterprises in Nigeria. The study therefore concludes that since equipment leasing has a significant effect on the organizational profitability of small and medium enterprises and that there is a positive and significant relationship between lease option and organizational performance. This has a lot of implication on the economy and the nation at large because if the businesses are doing well at the micro level due to availability of lease options, the Gross Domestic Product at the national level too would be influenced positively. Based on the findings of the study, the following recommendations are considered relevant:

1. Leasing companies should increase the awareness campaigns to operators of small and medium scale enterprises.
2. Leasing companies should improve on their rates by reducing rents on leasable equipment so that SME's can benefit more from this form of finance option.
3. Besides, leasing organizations should endeavor to understand the real requirements and scope of work of the small and medium enterprises so that they can provide real lease solutions that suit the corporate needs of the organizations.
4. Finally, small and medium enterprises operator should consider best option of financing their businesses in order to have a balanced cash flow and good cash liquidity for their operations.



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