Effects of Lease Options as a Source of Finance on the Profitability Performance of Small and Medium Enterprises (SME'S) in Lagos State, Nigeria

Akinbola, O. A.
Department of Management Sciences
Salem University, Lokoja, Kogi State, Nigeria
E-mail: akinbolafemi@yahoo.com

Otokiti, B. O.
Department of Business Administration And Marketing
Babcock University, Ilisan Remo, Ogun State, Nigeria
E-mail: busyayo02@yahoo.com

ABSTRACT

Over the years, the concept of leasing has been an element of serious decision for corporate organizations globally and it has been argued that leasing contribute to the growth of businesses. As such, this study is to ascertain the effects of lease option as a source of finance on the profitability performance of SME's and whether lease option has a relationship with the output of organizations. A cross sectional survey research method with the usage of questionnaire instrument is adopted using a multi-stage random sampling population of 300 respondents who are managers of SME's in Lagos State. Data were analysed using frequencies and simple percentage. The hypotheses were tested using Analysis of Variance and correlation analysis. The study discovers that lease option so far has positively affected the profit of the SME's. Also that lease option have relationship with organizational output of the companies. The study recommends that leasing companies should come up with leasing solutions that SME's can easily afford as to increase productivity and also increase the Gross Domestic Product of the economy and that SME's should endeavour to adopt the best financial structure to run their businesses thereby transforming the nation.

Keywords: *Leasing, Source of Finance, Profitability Performance*

INTRODUCTION

Organizations exist in competitive environment and they continuously seek ways to take lead in their business activities, also the quest for good financial management strategy is not contestable because every business needs a good and dependable cashflow to grow and this has necessitated the companies to seek for ways of reducing cost of operations especially when it comes to asset acquisition. Also, organizations have a lot of equipment and machineries to acquire which may not be really necessary to be bought but lease in order to have adequate capital for their operations. 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. Overall, small- and medium-sized enterprises constitute a significant sector in any economy. It is vital to understand what differentiates SMEs from other enterprises. There are various characteristics incorporated in SME definitions. These include turnover, assets, employment numbers, and management characteristics (Lee and McGuiggan, 2008). In some sectors, such as, agriculture or crafts, SMEs play a dominant role, whereas in others, such as financial institutions or communications, their importance is smaller (Korcsmaros, Takacs, and Dowers, 2003). A small- and medium-sized enterprise definition has been considered by several researchers (Berman, Gordon and Sussman 1997). The lack of a formal definition of a SME has led to different approaches followed by governments and other organizations in various economies (MacGregor and Vrazalic, 2008).

There is no common definition adopted for small-sized enterprise. According to (KPMG, 2003), small business is defined as one in which one or two individuals are required to make all important management decisions. This includes finance, accounting, personnel, purchasing, processing or servicing, marketing, selling, without the help of internal professionals and with particular understanding in only one or two functional areas. This early definition highlights the distinctive characteristics of a small business principal decision making and close control of operating activities by an owner-manager. Over the years, the concept of leasing has been an element of serious decision for corporate organizations globally and it has been argued that leasing have contribution to the growth of businesses. Though, there are three basic methods that businesses use to acquire an asset (borrowing, leasing and outright payment), nevertheless the question of cash liquidity and capital structure has been one of the basis for leasing. Correspondingly, Obadale as cited in Kurfi (2009) considers the incidence of capital structure of organizations and lease finance in multinational corporations. However the concept of organizational performance when it comes to the adoption of any form of leasing plan by small and medium enterprises in developing countries as Nigeria has received little attention in recent past. The study intend to identify if there is positive effects on leasing on organizational performance of SMEs and if leasing is an option that other like firms in the industry in Nigeria could consider to enhance profitability.

Leasing and its Advantages: Araga (1996) while citing Adewumi (1991) asserts that the concept of leasing has been described by the Equipment Leasing Association of Great Britain as a contract between lessor and lessee for the hire of a specific asset selected from a manufacturer or vendor of such asset by the lessee. The lessor retains ownership of the asset. The lessee has possession and use of the asset on payment of specified rentals over a period. In the traditional and contemporary finance literature according to Obadale (1999) as cited in Kurfi (2009), the main argument about asset acquisition for firms centres on the capital structure of the firm, that is, will the asset acquisition be financed from the firm's owned resources (equity) or through borrowing (debt)?

Leasing is an alternative mode of financing the acquisition of capital asset (Gordon, 1976). The other alternatives could be an outright purchase with one's resources (equity), debt (borrow and buy) financing, hire purchase, conditional sale or instalmental sale. The operations of firms are being financed through different media, ranging from fixed income securities debts and preferred stocks, to variable income securities, equities. Corporate capital structure is the firm's mix of different securities involving a choice between risks and expected returns. The number of companies involved in leasing from low ends, high end jobs to offshore destinations has increased to a very large extent so also the number of companies providing leasing services causing variety. Since firms increase in their experience and understanding of leasing as years go by with more companies outsourcing certain activities. It makes things much clearer therefore reducing the various risk that could be involved in outright purchase. The following are some of the advantages of leasing:

(i) ***Increased Productivity:*** Employment of a large number of skilled manpower at low cost due to high operational capital would result to increased productivity and customer satisfaction. (Nonaka and Takeuchi 1995).

(ii) ***Better Focus of Resources on Firm's Core Business:*** Companies want to spotlight their core competencies; they avoid getting entangled and wasting time performing task disadvantageous to those competencies therefore back offices are critical for the firm's everyday activities, the operation of the back office requires high maintenance and specialized concentration. By going for leasing, business can focus on their major activities (Vining and Globerman 1999).

(iii) ***Competitive Advantage:*** In recent times, for a company to retain its customers, provision of high quality services is of great importance. The company should also provide the services at cheap prices. Leasing in this case can help the company maintain lower rates with better service solutions, thereby giving them a better market position and competitive advantage. Organizations obtain sustained competitive advantage by implementing strategies that exploit their internal strengths, through responding to environmental opportunities, while neutralizing external threats and avoiding internal weaknesses (Brooks 2006).

Moreover, Nguyen and Sharpe (1995); Graham, Lemmon and Schallheim (1998) subscribe 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 yet 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 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 good is lower from its economic life duration (Smith and Wakeman, 1995). The firm avoids transaction costs generated by marketing costs useful to resale the good on the secondary market, which would explain a greater resorting to leasing by SME which absorb the financing of expenses in their activity with greater difficulty. 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. The primary objectives pertinent to this study are to ascertain the significant effects of lease option on the corporate profitability of organizations and their relationship between lease option and organizational output. Other objectives of the study are:

i. To determine whether lease option plays a significant role in profitability of Small Medium Enterprises?

ii. To ascertain whether there is a relationship between lease option and organizational output?

To achieve the above, the following hypotheses were formulated in null form to guide the study.

$H_0$1: Lease option has no significant effect on small and medium enterprises profitability.

$H_0$2: There is no relationship between lease option investment and organizational output.

METHOD

This study adopts cross-sectional survey research design. A sample of 300 business managers were randomly selected 30 Small and Medium Enterprise in Lagos State consisting of an average of 10 managers per organization. Out of the 300 copies of questionnaire administered on the respondents, 180 were successfully filled and returned. A multi-stage random sampling technique was adopted to select the male and female respondents who are managers. Purposive sampling method was employed due to the fact that this research was a very sensitive one and in order to carry out the study effectively, information about knowledge on leasing issues relating to finances were asked, whether respondent organizations has benefited from leasing as regards the choice of financing an equipment, knowledge on whether respondent's choice of leasing has affected the profitability of the firm positively, knowledge on whether respondent's ability to get lease options has influenced organizational output due to availability of resources by the lessor were collected from the respondents with the help of instrument. Data were analysed using frequencies and simple percentage. The hypotheses were tested using Analysis of Variance and correlation analysis.

RESULTS AND DISCUSSION

The results from the model summary table reveal the extent to which the variance in profitability of organizations can be influenced by lease option (R square = .081). The ANOVA table shows the F-cal 7.540 at 0.01 significance level which shows that lease option has significant effect on organizational profitability. The coefficient table above shows the simple model that expresses how lease option affects organizational profitability. The model is shown mathematically as follows; $Y = a + bx$ where y is organizational profitability and x is lease option, a is a constant factor and b is the value of coefficient. From this table therefore, organizational profitability of SME's = 1.883 + 0.399 lease option. This means that for every 100% change in organizational profitability, lease option contributed 39.9%. The significance level below 0.01 implies a statistical confidence of above 99%. This implies that lease option have significant effect on Small and Medium Enterprise's profitability. Thus, the decision would be to reject the null hypothesis. The correlation table for Hypothesis 2 shows a Pearson coefficient of .268 and N figure of 180 as regards significant relationship with respect to lease option and organizational output. The significance level below 0.01 implies a statistical confidence of above 99%. This implies that there is a positive and significant relationship between lease option and output of the organization. Thus, the decision would be to reject the null hypothesis. From the foregoing, lease option has no significance effect on small and medium enterprise profitability, also, there is no relationship between lease option investment and organisational output.

Table 1: Rates of Questionnaire Returned

Category	No of questionnaire administered	Percentage of total response
No of Returned	180	60
No of Not Returned	120	40
Total no of Questionnaires	300	100

Source: Field Survey, 2012

Table 2: Effects of Lease Options on the Organizational Performance of SME's

Variable	Frequency	Percentage
Whether they have lease option in the organization		
Yes	100	53.4
No	80	46.6
Total	180	100.0
Whether leasing has been beneficial		
Not really	50	28.4
To an extent	30	14.8
Very well	100	56.8
Total	18	100.0
Whether lease option has influenced small and medium enterprise profitability		
strongly disagree	40	25.0
Disagree	10	3.4
Undecided	10	10.2
Agree	30	12.5
strongly agree	90	48.9
Total	180	100.0
That leasing has assisted the company to improve organizational productivity		
strongly disagree	20	10.2
Disagree	20	11.4
Undecided	40	22.7
Agree	60	31.8
strongly agree	40	23.9
Total	180	100.0

Source: Field Survey, 2012

Table 3: Linear Regression Analysis

$H_0 1$ Lease option has no significant effect on Small and Medium Enterprise profitability

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.284(a)	.081	.070	1.198

Source: Field Survey, 2012

a Predictors: (Constant), Leasing has been beneficial

ANOVA(b)

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	10.827	1	10.827	7.540	.005(a)
	Residual	123.491	86	1.436		
	Total	134.318	87			

Source: Field Survey, 2012

a Predictors: (Constant), Leasing has been beneficial

b Dependent Variable: Lease option has influenced Small and Medium Enterprise profitability

Coefficients(a)

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta	B	Std. Error
1	(Constant)	1.883	.356	5.292	.000	
	Leasing has been beneficial	.399	.145	.284	2.746	.007

Source: Field Survey, 2012

a Dependent Variable: Lease option has influenced Small and Medium Enterprise profitability

Table 4: Correlation Analysis

$H_0$2 There is no relationship between lease option investment and organizational output

Correlations

			Leasing has been beneficial	Leasing has assisted the company to improve organizational productivity
Leasing has been beneficial	Pearson Correlation		1	.268(*)
	Sig. (2-tailed)			.012
	N	180	180	
Leasing has assisted the company to improve organizational productivity	Pearson Correlation		.268(*)	1
	Sig. (2-tailed)		.012	
	N	180	180	

Source: Field Survey, 2012

* Correlation is significant at the 0.05 level (2-tailed).

CONCLUSION AND RECOMMENDATIONS

On the basis of the afore-mentioned findings, the following deductions are expedient: The correlation and linear regression analysis employed for testing the two hypotheses revealed that; lease option have a significant effect on the organizational profitability of the small and medium enterprises and that there is a there is a positive and significant relationship between lease option and organizational output. This has a lot of implications 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, then Gross Domestic Product at the national level too would be influenced positively. The recommendations for this study include: firstly, that leasing companies should improve on their rates by reducing rents on leasable equipments so that SME's can benefit more from this form of finance option, secondly leasing organizations should endeavour 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. Finally small and medium enterprises are implored to 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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