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# Equipment Leasing: A Facet of Corporate Financing Strategy

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**ABSTRACT**
*The study examines leasing as a facet of corporate financing strategy in Nigeria. Structured questionnaire was used to elicit responses from the field. The data generated were tested using the Z-test and ANOVA statistical tool. The analysis shows that there is a significant negative relationship between corporate performance and sale lease back. The result also reveals that it is cheaper to lease equipment than to purchase outrightly. Our findings further reveal that there is significant difference between the cost of obtaining loan from financial institution and cost of leasing equipment in Nigeria. We recommend that captain of industries in Nigeria should take advantage of leasing option in acquisition of equipment, and Nigeria government should also re-visit tax laws with regards to leasing as available financing option.*

**Keyword**: Finance Leasing, Operating Lease, Sales and Lease Back

## BACKGROUND TO STUDY

Access to finance is one of the most widely discussed issues in recent times among financial experts world over. This is because it has become the major hindrance to industrialization. According to Adam and Hardwick (1998) ineffective domestic investment, poor economic growth and slow pace in poverty reduction experienced in most nations of the world is as a result of lack of access to affordable and reliable finance or credit to power their local industries. Lack of funds is a major challenge faced by captains of industries in developing nations of the world. According to Smith and Wakeman (1985) organizations exist in competitive environments and they continuously employ mechanisms that make them take lead in their line of businesses. The quest for good financial management strategy is not contestable because every business needs a good and dependable cash flow to grow their businesses. This has made it necessary for corporate bodies to seek for ways of reducing cost of operations especially when it comes to asset acquisition. In today's fast paced business environment, acquisition of modern equipment is imperative for long term growth and development but funds to acquire these equipment are not accessible. Gabara and Todaran (2011) observe that there is need as a matter of urgency for industrialists to develop other innovative financial products that would circumvent access pitfalls associated with traditional forms of financing. One form of such financing that has the ability to emerge as an innovative form of financing is lease financing (Westley, 2003). There is no doubt that most organizations need a lot of equipment and machineries to embark on smooth operations inspite of the fact that these equipment and machineries are costly. However, specialists have discovered that these equipment and machineries can be leased rather than purchased outright in order to have sufficient and adequate capital for operations. According to International Finance Corporation (IFC) (2004) leasing in its simplest form is a means of delivering finance. It is cheaper than the traditional means of borrowing. Miller (1990) is of the opinion that leasing, in effect, separates the legal ownership of an asset from the economic use of the asset. However the curiosity about the emergence of financial leasing as a common method of funding capital equipment led to much of the early research into the choice between leasing and buying.

## LITERATURE REVIEW

The term *leasing* is not uniformly defined and used in the literature. A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or transfer the right to use an asset for an agreed period of time. 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 remains legal owner of the asset and prevents lessee from becoming the owner of the property during the tenure of the lease. Miller and Upton (1978) opines that there is no significant difference between the present value of the costs of borrowing and a cost for outright purchase and costs of leasing. Both lease and debt are vital financing channels used by corporations. Traditional theories treat leases and debt as substitutes, that is, an increase in the use of lease financing should be associated with a lower level of conventional debt financing. Yet, empirical evidence on this relationship is mixed. Ang and Peter (1983) present a leasing puzzle by showing that lease and debt are complements even after controlling for differences in debt capacity. In the contrary, Marston & Harris (1988) and Krishnan & Meyer (1994) provide evidence suggesting that lease and debt are substitutes. The possible explanation for this empirical contradiction is that there is an unidentified factor embedded in previous studies. Schallheim (1992) reports that leases and debts can be complement since lessee can sell his tax shields and hence bear the cost of debt. In leasing arrangement the leased of economic goods are the centre of the financing. This implies that leasing contract in itself is principle at the value process and to the repurchase value of the economic goods. Extant literature reveals that leasing has increased dramatically, and instead of using the money to buy assets companies can commit their funds to leasing programs. Research works in recent times document that businesses utilities turned to leasing, because it is increasingly difficult to obtain loans from financial institutions. There are three major types of leasing; finance lease, operating lease, and sale and lease back. Most industrialists prefer operating lease because of its legitimate advantages. Lubove (2002) observes that depreciation, taxes and insurance costs are borne by the lessor. The most captivating advantage of operating lease is that it can be used as an off-balance sheet item. However many accounting scholars have faulted this arrangement because it fails to give the true state of a company's financial position. According to Spiceland, Sepe and Tomassim (2009) capital lease enables the companies to use and eventually own equipment that they could not ordinarily have fund to purchase. Jones (2011) stresses that change of ownership is the main feature that distinguishes capital leases from operating leases. Sale and leaseback is a hybrid form of leasing that enables the company to receive cash from sale of its asset. This transaction enables the company to receive money from the sale of means of production, without interrupting their operation. The company sells off its asset and at the same time sign lease agreement with the buyer. Lim (2002) opines that sale and lease back increases the firm cash flow.

## METHODOLOGY

### POPULATION AND SAMPLE

The population for this study comprises all construction and manufacturing companies quoted on the floor of the Nigerian Stock Exchange.

The sample size is twenty (20) companies. Ten companies is selected from the construction industry and Ten from the manufacturing industry using the simple random sampling technique. The sample size is determined by Mathematical Notation propounded by Yamani (1974); n = N/1 + N(e!)

Where N = Population size
n = Sample Size
e = Permissible level of sample error (1)

### SOURCES OF DATA

The data that were used for this study is the primary data. The primary data were obtained by administering questionnaire to elicit information from staff of purchase and procurement department of the selected companies. One hundred questionnaires were distributed to personnel of the aforementioned departments.

### RESEARCH INSTRUMENT

The research instrument for this research is Likert-type designed questionnaire, and two way questionnaire. This type of multiple choice questions is suitable for obtaining the respondents opinions on the subject matter. It indicates the extent to which respondents agree or disagree with given statement.

### RELIABILITY AND VALIDITY

Validity of the research instrument was checked by calculating content of validity index (CVI) which was found to be above 0.5. In a way to ensure reliability of the instrument and build confidence in the instrument, the researcher performed Cronbach's Alpha tests on the Likert scales used in the instrument.

### METHOD OF DATA ANALYSIS

This study used the Ordinary Least Square (OLS) regression technique to ascertain the relationship between lease option and corporate cash flow. Before we analyze our statistical data, we adopted some preliminary statistical test such as descriptive statistics and correlation matrix. Simple ANOVA test was performed to ascertain the best option for acquisition of equipment. The analysis of this research was conducted using Microsoft excel package.

**DATA PRESENTATION**

**Question 1: Leasing is a financial option for acquisition of equipment in Nigeria**

**Table 4.1**

| **Response** | **No** | **%** |
|---|---|---|
| Agreed | 30 | 30 |
| Strongly Agreed | 40 | 40 |
| Undecided | - | - |
| Strongly Disagreed | 21 | 21 |
| Disagreed | 9 | 9 |
| **Total** | **100** | **100** |

**Source: Field survey 2014**

The table 1 above reveals that 30% of respondents agreed and 40% strongly agree that leasing is a finance option for acquisition of equipment in Nigeria while 21% and 9% of the respondents strongly disagreed and disagreed respectively.

**Question 2: Leasing is cost effective**

**Table 4.2**

| **Response** | **No** | **%** |
|---|---|---|
| Agreed | 12 | 12 |
| Strongly Agreed | 53 | 53 |
| Undecided | - | - |
| Strongly Disagreed | 7 | 7 |
| Disagreed | 28 | 28 |
| **Total** | **100** | **100** |

**Source: field survey 2014**

The above reveals that 53% of respondents strongly agreed and while 12% just agreed that leasing is cost effective while 7% and 28% of the respondents strongly disagreed and disagreed respectively that leasing is cost effective.

**Question 3: It is cheaper to lease than to service loan obtained from financial institution**

**Table 4.3**

| **Response** | **No** | **%** |
|---|---|---|
| Agreed | 23 | 23 |
| Strongly Agreed | 47 | 47 |
| Undecided | - | - |
| Strongly Disagreed | 7 | 7 |
| Disagreed | 21 | 21 |
| **Total** | **100** | **100** |

**Source: Field survey 2014**

The table 4.3 above reveals that 23% of respondents agreed and while 47% strongly agreed respectively that it is cheaper to lease than to service lease loan obtained fund from financial institution. 7% and 21% of the respondents strongly disagreed and disagreed respectively that it is cheaper to lease than to service loan obtained from financial institution.

**Question 4: It is cheaper to lease equipment than outright purchase**
**Table 4.4**

| **Response** | **No** | **%** |
|---|---|---|
| Agreed | 2 | 2 |
| Strongly Agreed | 78 | 78 |
| Undecided | - | - |
| Strongly Disagreed | 10 | 10 |
| Disagreed | 10 | 10 |
| **Total** | **100** | **100** |

**Source: Field survey 2014**

The above table 4.4 reveals that 2% and 78% of respondents agreed and strongly agreed respectively that it is cheaper to lease equipment than outright purchase, and 20% of respondents combine to strongly disagreed or disagreed that it is cheaper to lease equipment than outright purchase.

**Question 5: Leasing is a corporate strategy that improves organization profit**
**Table 4.5**

| **Response** | **No** | **%** |
|---|---|---|
| Agreed | 43 | 43 |
| Strongly Agreed | 17 | 17 |
| Undecided | - | - |
| Strongly Disagreed | 12 | 12 |
| Disagreed | 28 | 28 |
| **Total** | **100** | **100** |

**Source: Field survey 2014**

The above table 4.5 reveals that 43% of respondents agreed and 17% strongly agreed respectively that leasing is a corporate strategy that improves organization profit, while 12% and 28% strongly disagreed and disagreed respectively that leasing is a corporate strategy that improves organization profit.

**Question 6: Sale and lease back does not in any way improve a company's cash flow**
**Table 4.6**

| **Response** | **No** | **%** |
|---|---|---|
| Agreed | 34 | 34 |
| Strongly Agreed | - | - |
| Undecided | - | - |
| Strongly Disagreed | 39 | 39 |
| Disagreed | 27 | 27 |
| **Total** | **100** | **100** |

**Source: Field survey 2014**

The above table 4.6 reveals that 34% of respondents agreed that sale and lease back improves the company's cash flow while 66% of the disagreed or strongly disagreed with the statement.

**Question 7: Equipment acquired by leasing is not taxed by the Nigerian tax authorities**

**Table 4.7**

| **Response** | **No** | **%** |
|---|---|---|
| Agreed | 7 | 7 |
| Strongly Agreed | 59 | 59 |
| Undecided | - | - |
| Strongly Disagreed | 23 | 23 |
| Disagreed | 11 | 11 |
| **Total** | **100** | **100** |

**Source: Field survey 2014**

Table 4.7 reveals that 7% and 59% of respondents agreed and strongly agreed respectively that equipment acquired by leasing is not taxed by the Nigerian tax authorities while 23% or 11% strongly disagreed and simply disagreed accordingly that equipment acquired by leasing is not taxed by the Nigerian tax authorities.

**Question 8: The processes involved in obtaining loan is not as complex as the processes involved in leasing contract**

**Table 4.8**

| **Response** | **No** | **%** |
|---|---|---|
| Agreed | 5 | 5 |
| Strongly Agreed | 3 | 3 |
| Undecided | - | - |
| Strongly Disagreed | 27 | 27 |
| Disagreed | 65 | 65 |
| **Total** | **100** | **100** |

**Source: Field survey 2014**

The above table 4.8 reveals that 5% and 3% of respondents agreed or strongly agreed that the processes involved in obtaining loan is not as complex as the processes involved in lease contract.

**DATA ANALYSIS**

**Test for Hypothesis One**

The cost of leasing equipment is not significantly less than the cost of outright purchase

**Table 9: Analysis of variance result (ANOVA)**

| **Group** | **Sum** | **p-value** | **F-critical** | **F** |
|---|---|---|---|---|
| Outright purchase | 20 | 0.03 | 5.3 | 6.5 |
| Lease | 80 | | | |

**Source: Micro Soft excel**

The analysis of variance reveals that 20% of the entire respondents opted for outright purchase while 80% opted for leasing. The P-value at 0.05 level of significant stood at 0.03 while F-value is 6.5. Since F-value of 6.5 is greater than F-cri of 5.3, we should reject the null hypothesis which connotes that leasing of equipment is significantly less than the cost of outright purchase.

**Test for Hypothesis 2**

**There is no significantly negative relationship between corporate performance and sale lease back.**

**Table 4.10: Result of Z-test**

| Group | Mean |
|---|---|
| Cash flow | 4.1 |
| Lease | 3.9 |

**Source: Ms Excel software**

Z = 1.64 (one tail test)
p = 0.014
Z = 2.17

Z = 1.9 (two tail test)
p = 0.029

The above table 4.10 result revels that value of Z is 2.17 for both one tail and two tail test. The critical values for one-tail and two-tail test are 1.64 and 1.9 respectively. We should reject null hypothesis at 0.05 level of significant since Z value of 2.17 is greater than critical of 1.64. In order to further confirm this we compared p-value with 0.05, since p-value is less than 0.05, we conclude that there is a significant relationship between lease and corporate performance. We also compared p-value at 0.025 and since p-value is greater than 0.025 we can say that there is a significant relationship between corporate performance and sale and lease back.

**Test for Hypothesis 3.**

**The cost of serving of loan is not significantly less than the cost of leasing**

**Table 4.11: ANOVA Result**

| Group | Sum | p-value | F | f-cri |
|---|---|---|---|---|
| Service | 70 | 0.08 | 10 | 18.8 |
| Leasing | 30 | | | |

**Source: MS-EXCEL SOFT ware**

The ANOVA result reveals that p-value has a value of 0.08 while the value of F is 10 at 0.05 level of significance. We do not reject null hypothesis since F-cri>F of 18.8 level of significance.

## DISCUSSION OF FINDINGS

The first objective sought is to assess the cost of outright purchase and that of leasing equipment in manufacturing companies in Nigeria. The findings of the study reveal that it is cheaper to lease equipment than outright purchase this is in conformity with the work of Beyene (2002) who argues that leasing is more cost effective than outright purchase. The second objective sought is to assess the relationship between corporate performance and sale and lease back. The findings reveal that there is a positive relationship between lease back and corporate performance. This result is in line with result of Bunney *et al.*, (2004) who discovered that there is a positive relationship between sale lease back and corporate performance. The third objective of the study is to find out if the cost serving loan is significantly less than the cost of leasing. The result reveals that there is a significant difference between cost for servicing loan and cost of leasing equipment in Nigeria. This result is contrary to the result of Abor (2007) whose findings reveal that servicing of long-term leasing is more than cost for serving bank loan in Zambian manufacturing sector.

## SUMMARY OF FINDINGS

This study examines leasing as corporate strategy in Nigeria industry. Structured questionnaire were used to elicit responses from the respondents out there in the field. The respondents responses were collated and put in a frequency distribution form, and then tested using F- statistical test, a member of the family of parametric tests and ANOVA. The responses from the respondents shows that

a. Manufacturing companies in Nigeria adopt leasing as a part of their financing strategy for acquisition of equipment.
b. The value of leasing in the industry experienced a remarkable increase in 2012
c. It is cheaper to lease equipment than to purchase out rightly the same.
d. Equipment lease back improves corporate cash flow.
e. Equipment leasing is a corporate financing strategy that improves profitability.
f. Cost of servicing loan is significantly more than the cost of leasing equipment.

## RECOMMENDATIONS

The last objective was to make recommendations to the Nigerian government, policy makers and other stakeholders on suggested ways to improve the state of financing options made available to industrialists in Nigeria. The following recommendations are given:

- Captains of industries in Nigeria should take advantage of this innovative means of financing to facilitate their operations.
- Companies should sell assets and sign lease agreement with lessor in times of financial crises.
- Manufacturing companies in Nigeria should lease equipment and invest the gain made from leasing on other ventures to further enhance growth of the company.

## REFERENCES

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**Please tick (√) as appropriate against the following questions.**

1. Leasing is a finance option for acquisition of equipment in Nigeria. Agreed( ) Undecided ( ) disagree strongly ( ) disagree ( )
2. Leasing is cost effective. Strongly Agreed ( ) agreed ( ) undecided ( ) disagree strongly ( ) disagree ( )
3. It is cheaper to lease equipment than outright purchase. Strongly Agreed ( ) agreed ( ) undecided ( ) disagree strongly ( ) disagree ( )
4. It is cheaper to service lease contract than servicing loan obtained from financial institute. Strongly Agreed ( ) agreed ( ) undecided ( ) disagree strongly ( ) disagree ( )
5. Leasing is a corporate financial strategy that improves organizational profit. Strongly Agreed ( ) agreed ( ) undecided ( ) disagree strongly ( ) disagree ( )
6. Lease back will improve a company's cash flow. Strongly Agreed ( ) agreed ( ) undecided ( ) disagree strongly ( ) disagree ( )
7. Equipment acquired by leasing is not taxed by the Nigerian tax authorities. Strongly Agreed ( ) agreed ( ) undecided ( ) disagree strongly ( ) disagree ( )
8. The processes involved in leasing contract are more complex than the processes involved in obtaining loan from financial houses in Nigeria. Strongly Agreed ( ) agreed ( ) undecided ( ) disagree strongly ( ) disagree ( )

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