**THE 14TH NATIONAL LEASE CONFERENCE 2016**

**THEME: LEASING AND ECONOMIC DEVELOPMENT IN CHALLENGING TIMES**

**TOPIC: LEASING INITIATIVES IN STIMULATING SMEs DEVELOPMENT AS A CATALYST FOR GROWTH**

**INTRODUCTION**

Leasing is referred to as asset based financing. Lessors retain ownership of the assets they lease throughout the life of the contract, these leased assets are therefore an inherent form of collateral in such contracts. Conventional bank lending focuses on the loan repayment by the borrower from two sources: a primary source, the cash flow generation, and a secondary source, credit enhancements and collateral (if any). Leasing is focused on the lessee’s ability to generate cash flows from the business operations to service the lease payments[[1]](#footnote-2)as the lessor retains legal ownership of the asset. Hence, leasing separates the legal ownership of an asset from its economic use. Ownership of the asset may or may not pass to the customer at the end of the lease contract. Based on contractual arrangements, the lessee is allowed to use an asset which is owned by the lessor; the lessee pays specified periodic rentals. The lessor relies on the lessee’s ability to generate sufficient cash flows to pay the lease rentals, rather than to rely on the lessee’s other assets or track record/credit history. Leasing enables borrowers with limited track record / credit histories and collateral to access the use of capital equipment, often even in cases where they would not qualify for traditional commercial bank lending. [[2]](#footnote-3)

**AFRICA’S FINANCIAL SECTOR**

The African financial sector has made significant progress in recent years. Financial inclusion has improved, facilitated in part by financial and technological innovations. Retail banking in Sub-Saharan Africa is projected to grow at a compound annual rate of 15 per cent to 2020.

However, Africa’s financial systems remain small, fragmented and among the least developed in the world. The range of institutions is narrow and only 23 per cent of African households have access to any formal or semi-formal finance. There is a chronic lack of long- term finance, which is perhaps most evident in the continent’s $93 billion annual infrastructure funding gap.[[3]](#footnote-4)

Africa’s longer-term financial sector development agenda is focused on building a financial system capable of mobilising and channelling a much larger share of domestic

resources to meet the needs of the real sector. Africa needs innovative financing solutions that move beyond traditional business models, to meet the changing needs of the continent.

Agriculture and agribusiness together account for nearly half of Africa’s GDP, and are

projected to be a $1 trillion industry by 2030. According to the World Bank, meeting

Africa’s demand for food requires $80 billion in investments annually. Access to

appropriate financial services is vital to realising Africa’s agricultural potential. Despite recent progress in the African financial sector, markets, institutions, and regulatory structures for long-term finance are all still in their early stages of development. African economies will be transformed when African financial systemscan provide term finance. When it can support expansions in companies’ productive capacity, finance investments such as equipment leases for farmers, and expand infrastructure like electricity, roads, and housing that the continent needs.

**SME FINANCING**

Micro, small, and medium size enterprises form more than 90 per cent of Africa’s

economic fabric, excluding agriculture. Mostly individual or family-run businesses

remain the leading providers of employment and services, operating in retail, smallscale

processing and household services. SMEs bring a host of socioeconomic benefits,

but largely they have not been provided with the technical and financial support they

need to flourish and meet their potential.

SMEs finance themselves to a great extent by internal sources, both from the business owner and through retained profit. Many SMEs also use external sources of finance, informal sources such as family and friends, some types of business angel investment and formal sources, such as bank loans, leasing, trade credits, factoring and more “formal” Venture Capital, which is important for a select group of high potential SMEs. [[4]](#footnote-5)SMEs usually have more difficulties in accessing external financing than large enterprises.

It has been established that Small and Medium enterprises play significant roles in the economic development of most developed and developing countries in terms of job creation, innovation ofnew ideas, contribution to Gross Domestic Product and welfare. It is therefore good to see various governments and other institutions supporting SMEs in their performance of such an important developmental role. However, the ability of an SME to improve its performance depends on investing, restructuring, innovation, market expansion, recruiting, maintaining and motivating quality staff. All of these require funding and access to external finance plays an important role in implementing all these actions so as to achieve the targeted growth and development of SMEs. However access to external finance for SMEs in developing countries is hampered by market imperfections - not only in times of crisis, but on an on-going basis as a fundamental structural issue, based on uncertainty between the demand side (entrepreneur) and the supplyside (financial intermediary). Nearly half ofSMEs in developing countries rate access tofinance as a major constraint. [[5]](#footnote-6)In recent research[[6]](#footnote-7)on SMEs access to external finance in the sub-Saharan Africa, it is established that most SMEsin the region might not be able to access financefrom local banks at all, or face stronglyunfavourable lending conditions.[[7]](#footnote-8)“Small firms are disproportionately handicapped by a lack of finance, but they receive a stronger boost in growth than larger firms if financing is provided”.

Some researchers attribute SMEs limited access to credit to the fact that most economies of developing countries are poorly developed in the banking sector. So far, research has revealed a credit gap of well over $2 trillion for SMEs inemerging markets. The gap for formal SMEs alone was close to $1 trillion. The estimated credit gap for formal and informal MSMEs worldwide has been revised upwards from $3.2 to $3.9 trillion globally, of which $2.1 to $2.6 trillion is in emerging markets. [[8]](#footnote-9)This has beenattributed to a number of factors including limited access to capital markets, financial institutionsand poor managerial practices. The situation is not different in Africa, as financial constraints together with corruption have been cited as the major obstacles to SMEs growth. The African Development Bank (AFDB) confirmed in their recent research on access to finance by SMEs in Africa that 20% of African SMEs have access to external finance in contrast with what pertains in other developing countries in South America and Caribbean where 44% of SMEs have access to bank credit .

**WHY LEASING ?**

Leasing is often seen as a substitute for medium to long term credit, but the answer to the question whether leasing and debt are substitutes or complementary is not trivial and has in financial literature not resulted in a clear conclusion. In traditional corporate finance the decision of buying versus leasing is mostly discussed in the context of the world of perfect capital markets, where in general the capital structure is irrelevant for the determination of the firm value.[[9]](#footnote-10) But in real financial markets, there are market imperfections. In the area of access to finance for SMEs, a market imperfection/failure is not only present during a deep recession or a financial crisis but also on an on-going basis as a fundamental structural issue. The reasons for a market imperfection/failure relate to insufficient supply of capital (debt or equity) and inadequacies on the demand side.[[10]](#footnote-11)

**THE NIGERIAN SITUATION**

Nigeria has in recent times experienced a dip in its macroeconomic indices. Inflation reached a six year high and GDP fell below 2.8% in this year of 2016. All of this taking place while the country experienced the free fall of the exchange rate for the Naira. Insecurity was rife this year with increased bombing of oil production facilities in the Niger Delta, skirmishes between the cattle herders and farmers, and terrorist activities of the Boko Haram Sect. The country has now been declared to be in a recession.

The Federal Government of Nigeria is taking a close look at our economy and is encouraging economic diversification to reduce reliance on revenues from oil and gas exports. The government plans to stimulate the economy through greater public spending and it hopes to boost non-oil revenues by 1.6 trillion in 2016. Several sectors of the non-oil economy are expected grow such as mining, agriculture, telecoms, manufacturing etc.

In this time of a recession, the leasing industry has shown great signs of growth. It grew from N869 Billion in 2014 to N1.1 Trillion in 2015. However the oil and gas sector made the largest contribution to the 2015 results with a 33% contribution of N361 Billion. Whereas agriculture contributed a mere 7% amounting to N74 Million.[[11]](#footnote-12) In line with the current drive for the diversification of the economy, it will do the economy a lot of good if the leasing industry would begin to focus more on the non-oil sector of the economy. As has been reiterated earlier, leasing is a source of financing for SMEs.

It is said that non-bank lessors contribute 80% of lease transactions. Most of these leases are in the area of consumer goods.[[12]](#footnote-13) There needs to be more effort by the non-bank lessors to engage in leasing of specialised assets. These specialised assets are such as will unleash the potential of SMEs and enable them reach their full potential. Lessors need to look at such equipments as agricultural equipment, medical equipment, processing and production equipment etc. these are the things which facilitate businesses and enable them to grow and contribute to the development of the nation’s economy. They will create wealth and create jobs. They will innovate and create competitive products and services and ultimately earn revenues that the leasing industry will certainly benefit from.

The Equipment Leasing Act (2015) provides the legal framework which should support investments in the industry. As the industry works to improve its access to long term funding and attract new investors to the business, Lessors need to key into the enourmous opportunities that abound through the financing of SMEs through leasing in all growth oriented sectors of the economy.

**CONCLUSION**

My firm Toki Mabogunje and Co. is a business development service provider. We serve SMEs assisting with their business development and growth issues. We joined the membership of ELAN in the belief that leasing is one of the keys to unlocking the potential of the SME. ELAN can attest to the number of our clients we have sought to assist through the membership of the association. But it has not always been easy due to the focus of lessors on general items for actors in the non-oil economy. It is my hope that the foresight of ELAN in choosing the theme: **LEASING AND ECONOMIC DEVELOPMENT IN CHALLENGING TIME,** will lead the body of the membership of ELAN into taking decisive action. There is no time better than now for the Leasing Industry to position itself as a financing solution for SMEs .

It is my hope that ELAN will after this conference put together a plan of action which will help put the association in the position of leadership which it needs to occupy, Riding on the waves of recession into recovery, birthing SMEs in the competitive space contributing more significantly to the country’s GDP than hitherto.

1. Gallardo, 1997 [↑](#footnote-ref-2)
2. Gallardo, 1997; Berger and Udell, 2005 [↑](#footnote-ref-3)
3. Making Finance Work 4 Africa 2015 Annual Report [↑](#footnote-ref-4)
4. EIM, 2009 [↑](#footnote-ref-5)
5. British Journal of Economics Management and Trade 9(4): 1-9 2015. “Leasing an alternative source of financing for small and medium enterprises in Ghana.” [↑](#footnote-ref-6)
6. Becks and Cull [↑](#footnote-ref-7)
7. Becks and Cull [↑](#footnote-ref-8)
8. IFC Enterprise Finance Gap Database 2011 [↑](#footnote-ref-9)
9. Modigliani and Miller 1958 [↑](#footnote-ref-10)
10. Akerlof, 1970 and Arrow, 1985 [↑](#footnote-ref-11)
11. ELAN Leasing today Vol.16 No.2 2016 [↑](#footnote-ref-12)
12. ELAN Leasing Today Vol.16 No.2 2016 [↑](#footnote-ref-13)