Lease Financing and Financial Performance of Listed Manufacturing Companies in Nigeria

Abayomi Ayoola AREMO[1] and Yemisi Oluwafunmilayo AYORINDE[2]
[1] Department of Banking and Finance, Adekunle Ajasin University, Akungba Akoko
[2]Ecobank Nigeria Plc.

Citation: Abayomi Ayoola, Aremo and Yemisi Oluwafunmilayo, Ayorinde (2022) Lease Financing and Financial Performance of Listed Manufacturing Companies in Nigeria, *European Journal of Accounting, Auditing and Finance Research*, Vol.10, No. 6, pp.1-8

ABSTRACT: *This study examined the effect of lease financing on the financial performance of listed manufacturing companies. The study relied on secondary data which covered the period of 2011 to 2021. It was established from findings that financial lease create positive effect on financial performance of companies through the creation of opportunities to use capital intensive assets in production activities. However, the insignificant effect of lease financing in the study suggests the underutilisation of leasing financing options by manufacturing companies. It was recommended that lease financial should be extensively explore by manufacturing companies. In addition, companies should endeavor to maintain appropriate balance between different source of financing, investment opportunities and performance.*

KEYWORDS: lease financing, financial performance, listed manufacturing companies, Nigeria

INTRODUCTION

Financing decision is one of the core financial decision of corporate organisations in a modern economy. Financing decision represents different sources of finance through which corporations financed their investment and operational activities for the maximisation of shareholders wealth. Financing decision of corporations has received high attention among scholars and practioners as a result of its implication on the capital structure, dividend policy as well as capital budgeting decisions (Atseye, Mboto & Lawal, 2020). One of the major methods of financing corporate assets is through lease financing. Leasing financing which has experienced significant growth in the recent years, involves a formal arrangement between a lessor and lessee wherein the lessor gives permission for the usage of assets to the lessees for a long period of time for the payment of rentals (Salam, 2013; Awwad & Ruzieh, 2021).

Alsayeh (2009); Olabisi, Epudu and Danfe (2015) viewed lease financing as the process of purchasing or using equipment or other physical assets without making installment payment for future payment. Leasing has been recognise to be important source of financing in both developed and developing countries. Akinbola and Otokiti (2012) asserted that lease financing result from a high of business competition and innovation of advance technologies. The inability of manufacturing companies to purchase these capital intensive technologies led them to result to leasing financing to aid business growth and compete favourably in the market (Obiero, 2014; Olabisi, *et al.,* 2015). To this end, lease financing has been recognised as the effective means of improving financial performance of firms (Imhoff, Robert & David, 2004; Webster, 2012). According to Erickson (2004) companies prefer to lease equipment or machineries in order to conserve cash flow and capital. Tarus (1997) opined that leasing enhances the level of financial performance through the reduction of financial level and improves working condition.

Theoretically, the pecking order model of capital structure proposes leasing to be in the highest order in external financing as a result of it low costs and risk implications on the operational activities and performance of an organisation (Marston & Harris, 1988; Krishna & Moyer, 1994). The significant benefits argued in favour lease and it implications of financial performance of corporate organisations as oppose to the acquisition of assets or equipment involves tax reduction effects, debt sustainability, agency costs, free cash flows and liquidity strengthening (Miller & Upton, 1976; Ang & Peterson, 1984; Smith & Warner, 1979). As a result of this, leasing has provides more financing mechanism globally than commercial papers, medium term-notes, corporate bonds and international equities.

The manufacturing sector of an economy represents core sector, the Nigerian manufacturing sector inclusive. This is because of the role of the sector in creating employment opportunities, contribution to foreign earnings and trade as well as contribution to government revenue through transformation of raw materials into finished goods. In addition, the manufacturing sector in the recent years has led the industrial revolution of most countries through technological innovation and advancement. However, the achievement development in the manufacturing sector requires capital intensive technologies which requires huge capital outplay. The Nigerian manufacturing sector despite it significant role in the economy has encountered diverse challenges with lack of financing to aid long term investment in equipment. This is worsen by global financial crisis, credit crunch, high interest rate and short term lending orientation of commercial banks. Hence, the need for more effective source of finance through lease financing. While lease financing has been a popular means of financing over the years to the entrepreneurs especially the manufacturing industries, the level of lease consumption is relatively low in Nigeria compared to Ghana, South Africa, Zambia, Uganda, Tanzania etc (Oko & Essien, 2014). While diverse works have been examined on the topic lease financing and its performance on some sectors in an economy both in Nigeria and some emerging countries (Obiero, 2014; Bello, Almustapha, 2016; Atseye, *et al.*, 2020) little efforts have been made in the recent years to examine the effect of lease financing on the manufacturing sector in Nigeria. Thus, the main objective of this article is to examine the effect of lease financing on the financial performance of manufacturing sector in Nigeria.

LITERATURE REVIEW

The relationship between lease financing and the performance of manufacturing firm has received central focus. Lease financing creates contractual arrangement between the owner of asset and user of assets wherein the user of asset is permitted to use an asset with the obligation for payment of lease fees (Awwad & Ruzieh, 2021). Under the lease financing arrangement, the lesser make payment for the purchase of an asset with the intention of shifting usage of the asset to the lessee with the purpose of creating future installment or full payment at some point in time wherein the asset is return or out rightly purchase by the lessee following the completion of the lease agreement period (Atseye, *et al.*, 2020). Therefore, the ownership of the asset may or may not be pass unto the lessee based on the lease agreement or contractual obligation binding the lease contract. Literature have identified different forms of lease which includes financial lease, operating lease, sale and lease back, leverage leasing, service lease, direct leasing and international leasing among others.

Lease financing has been seen as an effective means of creating financial freedom to firms that lack the capital to undertake investment in capital intensive assets. Theoretically it is expected that lease financing would enhance the performance of manufacturing sector in an economy. This is because leasing helps the manufacturing sector in acquiring vital equipment needed to enhance and increase productivity, thereby increasing financial performance of firms. The advantages accrued from lease financing include reduction of taxation, saving of cost, sustainability of debt, creation of cash flows and improving of liquidity position which makes lease financing more preferable to direct purchase of assets by large manufacturing companies (Miller & Upton, 1976; Ang & Peterson, 1984; Smith & Warner, 1979). While there are few studies conducted on leasing financing, quite number literature have made efforts in establishing the financial and performance implication of lease financing. For instance, Lackerath-Rovers (2006) adopted logit and ordinary regression to investigate the determinant of operating for 281 companies in the Dutch Stock Exchange in Netherlands, operating lease was established to be influenced by performance, growth and investment opportunities, size, leverage and ownership structure of firms.

By sampling 2,343 UK-quoted companies over the period 1989-2002, Meziane (2007) studied the financial drivers and implications of leasing on real estate’s assets and it was discovered that firms that involve in leasing of assets reached growth stage. This findings tends to align with the result of Lasfer and Levis (1998) who discovered that high growth companies more likely engage leasing of plant and machinery as a result of increase in the cost purchasing an assets. A study conducted by Hassan (2009) on the effect of lease finance showed that finance lease has significant positive impact on the profitability of Nigerian banks. Focusing on the effect of lease finance on the profitability of 300 SMEs in Nigeria, Akinbola and Otokiti (2012) discovered from the analysis of variance and correlation result lease finance impacts positively on the profit of SMEs. The empirical result of Kibuu (2015) in Kenyan showed that lease financing is positive in determining the performance of firms listed in the stock exchange market.

Olabisi, *et al.*, (2015) also investigated the determinants of leasing decision among quoted manufacturing 173 companies in Nigeria based on data from 173 analysed with Ordinary Least Squares (OLS) methods. It was discovered that profitability played a positive role in the leasing decision of manufacturing companies. However, findings from the study of Umar, Hannatu and Aliyu (2016); Bello and Almustapha (2016) showed that lease financing had negative relationship with liquidity position of oil and gas companies in Nigeria. Focusing on the effect of operating lease on credit ratings, Kusano (217) discovered that capitalised operating lease and finance lease had significant association with credit ratings. Atseye, *et al.*, (2020) investigated the relationship between lease financing and profitability of 6 conglomerates from 2012 to 2017 in Nigeria analysed with pooled ordinary least square regression. It was discovered from the study that lease financing positive but insignificant effect on return asset. The study of Awwad and Ruzieh (2021) which focused on the effect of financial leasing on the performance of Islamic bank in Palestine showed that financial leasing had significant effect on financial performance.

METHODOLOGY

This study is based on quantitative research method and hence employed ex post facto research design to uncover the relationship between leasing financial and financial performance. Ten (10) listed manufacturing companies were selected for the study and data covered the period of 2011 to 2021. The companies selected are United Africa Company of Nigeria, PZ. Cussons Nigeria Plc., Nigerian Breweries Nigeria Plc., Cadbury Nigeria Plc., Flour Mills of Nigeria, Promasidor Nigeria Limited, Nestle Nigeria Plc., Unilever Nigeria Plc., Dangote Floor Nigeria PLC., and Guinness Nigeria Plc. This companies were selected based on the level of financial activities, updated financial statement and availability of variables germane for the study. Manufacturing sector performance is dependent on lease financing. Profit after Tax was employed as a measurement financial performance. Furthermore, financial lease was employed as independent variable following the study of Atseye, *et al.*, (2020); Awwad and Ruzieh (2021) while total liabilities and total asset were used as control variables Akinbola and Otokiti (2012); Olabisi, *et al.*, (2015); Atseye, *et al.*, (2020).

Model and Data Analytical Techniques

For the purpose of this study the underlying model is developed to evaluate the relationship lease financing and manufacturing sector finance performance in Nigeria and it is given as:

PAT = *f*(FL, TL, TA)

This is formulated in a panel linear form as:

$LPATi_t = \beta_0 + \beta_1 LFL_{it} + \beta_2 LTL_{it} + \beta_3 LTA_{it} + e$

Where: PAT= Profit after Tax. FL = Finance Lease. TL = Total Liabilities. TA = Total Asset. $\beta_0 =$ Constant. β_1- β_3 = Coefficient of the parameters t = Time Script of Common Variables across the Cross Section i = Individual manufacturing firms. e = Error Term. L = Log Number of the Variables.

Empirical Results

Table 1: Descriptive Statistic

	LPAT	LFL	LTL	LTA
Mean	15.8	21.6	24.3	25.0
Std. Dev.	1.25	1.35	1.15	0.83
Kurtosis	2.84	1.31	2.08	2.15
Jarque-Bera	1.15	4.03	2.02	1.57
Probability	0.56	0.13	0.36	0.45

Table 1 presents the result of the descriptive statistics on the study variables and it shows that the variables namely log of profit after tax, log of financial lease, log of total liabilities and log of total asset have increasing average value over the study period. The result further shows that the variables are leptokurtic indicating stability over time. Finally, the Jarque-Bera test indicates that all the variables are normally distributed with probability values which are above the acceptance region of 5%.

Table 2: Pearson Correlation Matrix

	LPAT	LFL	LTL	LTA
LPAT	1.000000			
LFL	0.103789	1.000000		
LTL	0.479607	0.110709	1.000000	
LTA	0.455492	0.174039	0.982536	1.000000

The result presented in Table 2 shows that the variables are not characterized with the problem of multi co-linearity. Furthermore, financial lease, total liabilities and total asset have direct and weak correlation with profit after tax of the selected companies in Nigeria.

Table 3: Panel Result Result

	Pooled Regression Panel			Random Effect Regression Panel		
Variable	**Coef.**	**t-Stat.**	**Prob.**	**Coef.**	**t-Stat.**	**Prob.**
LOG(LE)	0.043687	0.282781	0.7794	0.205707	0.843861	0.4057
LOG(TL)	-0.094127	-0.152804	0.8796	-0.792533	-0.898073	0.3765
LOG(TA)	0.977974	2.169275	0.0018	0.451495	3.374802	0.0105
C	-7.358524	-2.931715	0.0092	3.404973	3.280598	0.0010
R-squared	0.843709			R-squared 0.735785		
Adjusted R-squared	0.775816			Adjusted R-squared 0.646384		
F-statistic	5.062562			F-statistic 10.51882		
Prob(F-statistic)	0.006093			Prob(F-statistic) 0.030537		
Durbin-Watson stat	1.972760			Durbin-Watson stat 1.950069		

Hausman Test			
Test Summary	**Chi-Sq. Statistic**	**Chi-Sq. d.f.**	**Prob.**
Period random	5.102260	3	0.1645

The Hausman test is performed to determine the model that produces consistent and efficient estimates between both the random and fixed effect model. From Table 3, the chi-square (x^2) is given as 5.102260 with p-value of 0.1645 which is statistically insignificant at 5%, thus leading to the acceptance of the null hypothesis that random effect model produce a better estimate. Thus the random effect regression is considered appropriate and reported in this study.

Based on the random effect result presented in Table 3, it is found that log of financial lease has positive but insignificant effect on log profit after tax which implies increase in financial lease will lead to 0.21% in profit after tax. The result further shows that log of total liabilities has negative and insignificant effect on log of profit after tax suggesting that increase in total liabilities will lead to 0.72% fall in profit after tax. Finally, the random effect shows that there is positive and significant relationship between log of total asset and log of profit after tax indicating that increase in total asset will lead to 0.45% increase in profit after tax

Table 4: Diagnostics

Diagnostics test	Ch-square	P-value (Chi-square)
Jaque Bera Normality Test	0.95005	0.6219
Breusch-Pagan LM	9.493648	0.4860

The result of the residuals diagnostics test is presented in Table 6 shows that the residual of the model is normally distributed given a probability value of 0.6219 which above the acceptance region of 5%. Finally, the cross sectional dependency test reveals that there is no cross-section dependence (correlation) in residuals of the panel model with a chi-square value of 0.4860 which is greater than 5%.

Discussion and Implications of Findings

The result of the study based on the random effect regression revealed that financial lease had positive and insignificant effect on profit after tax. The implication of this result is that financial lease has the capacity to enhance financial performance, however, the insignificant effect of financial lease shows the underutilisation of financial lease source of financing in Nigeria. This study conformed to the findings of Lackerath-Rovers (2006); Atseye, *et al.*, (2020) but in contrary with findings of Umar, *et al.*, (2016); Bello and Almustapha (2016) who found that lease financing have a negative impact on financial performance of businesses.

Furthermore, the result indicated that total liabilities had negative and insignificant effect on profit after tax. The implication of this finding is that as firms relies more loan compared to internal or equity finance, there profit will be affected negatively. The finding conformed to the result of Orabi (2014) who established that total loan had negative effect on profit after tax but contradict the empirical result of Salam (2013) who found that total loan had positive effect on profit after tax of companies. Finally, it was revealed that total asset had positive and significant effect on profit after tax of the selected companies in Nigeria. The implication of the finding is that effective and efficient utilization of assets during operational activities will enhance profit after tax of companies. This finding corroborate with the result of Akinbola and Otokiti (2012) who found that total asset had positive and significant effect on total asset.

CONCLUSION AND RECOMMENDATIONS

The study concluded that financial lease produced an increasing effect on the financial performance of manufacturing companies in Nigeria. It was discovered that financial lease creates opportunity for firms to use advance and capital intensive assets that arte cost to acquire directly. In addition, through lease financing firms are able to build liquidity position and reduce tax implication which increase cash flows for maintenance of operational activities. Surpassingly, financial lease was found to have insignificant effect on financial performance which suggests the underutilisation of lease financing options among companies. It was thus suggested that manufacturing companies should extensively explore lease financing options as an important financing decisions. There is need for companies to strike proper balance between different source of financing, investment opportunities and performance.

References

Akinbola, O.A. & Otokiti, B.O. (2012). Effects of Lease Option as a source of finance on the Profitability Performance of SME's in Lagos State, Nigeria. International *Journal of Economic Development Research and Investment, 3*(3), 70-76.

Alsayeh, A. (2009). Leasing in Jordan, the current reality and future, *Journal of Jordanian banks, 4*(2), 22-34

Ang, J. & Peterson, P. (1984). The leasing puzzle. *Journal of Finance, 39*(4), 1055-1065.

Bello, U. & Almustapha, A. A. (2016). The impact of lease financing on the liquidity of Nigerian oil and gas industry. *International Journal of Economics, Commerce and Management, 4*(1), 253 – 264.

Hassan, S. U. (2009). The Impact of finance lease on the profitability of Nigerian banks. *Journal of Finance and Accounting Research, 1*(3), 28-36.

Imhoff, E. A., Robert, C. L., & David, W. W. (2004). Operating leases: Impact of constructive capitalization, *Accounting Horizons, 5*(1), 51-63.

Kibuu, M.K. (2015). The effects of lease financing on the financial performance of companies listed in Nairobi securities exchange. A research project submitted in partial fulfillment of the requirements for the award of the degree of Master of Science in finance, school of business, University of Nairobi.

Krishnan, V. S., & Moyer, R. C. (1994). Bankruptcy costs and the financial leasing decision. *Journal of Financial Management 23,* 31-42.

Kusano, M. (2017). Effect of capitalizing operating lease on credit ratings. Evidence from Japan. *Journal of International accounting, auditing and taxation, 16*(16), 1-35.

Lackerath-Rovers, M. (2006). Operating leases disclosures: an empirical investigation. Handelsad NLS, unpublished Ph. D Thesis.

Marston, F., & Harris, R. S. (1988). Substitutability of leases and debt in corporate capital structures. *Journal of Accounting, Auditing and Finance, 3,* 147-170.

Meziane, L. (2007). On the financial drivers and implications of leasing real estate assets: The Donaldsons-Lasfer's Curve. *Journal of Corporate Real Estate, 9*(2), 72-96.

Miller, M., & Upton, C. (1976). Leasing, buying and the cost of capital services. *Journal of Finance, 31*(3), 761-786

Obiero, J. (2014). *Effects of lease financing on the financial performance of companies listed on Nairobi securities exchange*. A research project submitted in partial fulfillment of the requirements for the award of the degree of Master of Science in finance, university of Nairobi.

Oko, A. E. & Essien, E. E. (2014). The prospects and challenges of market segmentation practices in the Equipment Leasing Industry in Nigeria 2000-2013. *Journal of Business Theory and Practice, 2*(1), 28 – 62.

Olabisi, J., Ekpudu, J.E. & Dafe, P.O. (2015). Determinants of leasing decision in Nigerian quoted manufacturing companies. *Arcb Achives*, *2*(1), 1-12.

Orabi, M. A. (2014). The impact of leasing on the financial performance of industrial companies listed on the Amman stock exchange. *Global Journal of Management and Business Research*, *14*(2), 25-44.

Salam, M.D. (2013). Effects of lease financing on performance of small and medium scale enterprises in Bangladesh. *International Journal of Science Research*, *2*(12), 367-370.

Smith, C. W., & Warner, J. B. (1979). On financial contracting: An analysis of bond covenants. *Journal of Financial Economics*, *7*, 117-161.

Tarus, K. (1997). Determination of the factors influencing the growth of finance leases in Kenya. Unpublished MBA Research paper, University of Nairobi

Umar, B., Hannatu S.A. & Aliyu, A.A. (2016). Impact of lease financing on liquidity of Nigerian oil and gas companies. *International Journal of Economics, Commerce and Management United Kingdom*, *4*(1), 253-264.

Webster, J. (2012). *Introduction of Financial Management*. New York: McGraw.