ADDIS ABABA UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING AND FINANCE

CHALLENGES AND PROSPECTS OF LEASE FINANCING SMALL AND MEDIUM ENTERPRISES IN ETHIOPIA: EVIDENCE FROM DEVELOPMENT BANK OF ETHIOPIA

A THESIS SUBMITTED TO THE SCHOOL OF GRADUATE STUDIES OF ADDIS ABABA UNIVERSITY, COLLEGE OF BUSINESS AND ECONOMICS

FOR THE PARTIAL FULFILLMENT FOR THE DEGREE OF MASTERS OF SCIENCE IN ACCOUNTING AND FINANCE

BY: MENGISTU ARARSA BEKELE ID No, GSD/9524/08

ADVISOR: ALEM HAGOS (PhD)

JUNE, 2019

ADDIS ABABA

DECLARATION

I, Mengistu Ararsa, declare that this thesis is my original work and has not been presented for any degree in any other universities, and that all the sources of materials used herein have been duly acknowledged.

Declared by:

Name: ____

Date: ____

Signature: ____

CHALLENGES AND PROSPECTS OF LEASE FINANCING IN ETHIOPIA: EVIDENCE FROM DBES' SMALL AND MEDIUM ENTERPRISES

BY: MENGISTU ARARSA

A THESIS SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF MASTER OF SCIENCE IN ACCOUNTING AND FINANCE

ADDIS ABABA UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

ACCOUNTING AND FINANCE PROGRAM UNIT

ADVISOR: DR. ALEM HAGOS

JUNE 2019

ADDIS ABABA

Certification

This is to certify that Mengistu Ararsa has done a study on the topic "Challenges and Prospects of Lease Financing in Ethiopia: The Evidence from Development Bank of Ethiopia's Small and Medium Enterprises." This study is of his original work and all the sources of materials used for the research paper had been duly acknowledged.

Advisor's Name: DR. ALEM HAGOS

Signature: ___________________________

Date: _______________________________

Place: Addis Ababa University

ACKNOWLEDGEMENT

I would like to thank and praise the Almighty God for being my savior and source of strength to successfully complete this study. My special and sincere gratitude goes to my advisors DR. ALEM HAGOS for I had a great fortune to study under his supervision and I am very grateful for his guidance and encouragement. His profound knowledge provided me with opportunity to broaden my knowledge and to make significant progress.

My appreciation also goes to the management and staff of the DBE special Head office lease Financing wing and District office team manager, and all those who took part in providing the necessary data through questionnaires and interviews.

Lastly but not least, I wish to express my heart-felt gratitude to my families for their being with me and moral support in my entire Journey that the dedication of the thesis is given to them.

June, 2019

Mengistu Ararsa

ADDIS ABABA UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

ACCOUNTING AND FINANCE PROGRAM UNIT

CHALLENGES AND PROSPECTS OF LEASE FINANCING IN ETHIOPIA: EVIDENCE FROM DBES' SMALL AND MEDIUM ENTERPRISES

By: Mengistu Ararsa

Approved By the Board of Examiners:

______________________________	________________________
Advisor	**Signature**
______________________________	________________________
Internal Examiner	**Signature**
______________________________	________________________
External Examiner	**Signature**

Abstract

Lease financing is an alternative means of and sophisticated mechanism to fill gaps of finance accessing. The main target of this study is to examine the major challenges and prospects of lease financing Small And Medium Enterprises in Ethiopia particularly in Development Bank of Ethiopia assessing its current performance by focusing on some basic points like: challenges of lease financing that may affect lease financing practice and identify the nature of leasing and the opportunities or market potential currently exist on lease financing. The study used both qualitative and quantitative method. Both primarily and secondary data also used as an evidence for the study. In identifying the respondent from the study of the population, a purposive sampling method adopted. For the total population of 211 staffs of DBE in Addis Ababa used to take 138 sample respondents. The data analyzed through descriptive statistics by SPSS that involves tables, frequency distribution, and percentages were used for analysis. Based on the result, the study has identified challenges that the bank faces as, the bank's Small and Medium Enterprise selection criteria, poor supply chain with absence of proper and sufficient suppliers of capital goods, macro-economic instability like inflation and currency fluctuation, poor quality of financial statements of Small and Medium Enterprises, lack of sufficient demand (absence of Small and Medium Enterprises), Lack of knowledge about Small and Medium Enterprise Lease financing, poor management of credit risk by the bank and lack of proper internal policy and procedures that minimizes the cost associated with Small and Medium Enterprise lease financing loans. The study recommends for the development of specific legal and administrative framework for SME lease financing and the bank should not rely only on the asset of the SMEs as selection criteria and have strong internal policies and procedures; the bank should also have good credit management unit that have flexible preventive indicators to detect possible deterioration of SME loans; intensive Awareness creation should have to done by stake holder about lease financing; the bank should also have experienced and dynamic credit analyst that have flexibility in reducing risk of SME loans. In contrary to its challenge, SME lease financing has a positive outlook and recently experiencing positive development. There is a growing interest by the government, as well as by private sector players, to integrate leasing as a crucial instrument to address the gap in access to finance and meet economic growth targets.

KeyWords: Lease, Lease Finance, Small and Medium Enterprises, Challenge

Table of Contents

Acronyms and Abbreviations

DBE: Development Bank of Ethiopia

EIB: European Investment Bank

EIC: Ethiopian Investment Commissions

GDP: Gross Domestic Product

GTP: Growth and Transformation Plan

GTPI: Growth and Transformation Plan One

GTPII: Growth and Transformation Plan Two

IDA: International Development association

IFC: International Financial Corporation

MoT: Ministry of Trade

NBE: National Bank of Ethiopia

SME: Small and Medium Enterprise

List of Tables

CHAPTER ONE

1. INTRODUCTION

1.1 Background of the Study

It is well known that Small and Medium sized Enterprises (SMEs) are the backbone of the economy. Most of these companies use external financing sources like borrowing and equity capital to finance their activities. However, in general, in the area of SMEs' access to finance, there are market imperfections based on uncertainty and asymmetric information between the demand side (entrepreneur) and the supply side (financial intermediary). Various surveys on access to finance show that bank loans and overdrafts are the most widespread debt financing methods for SMEs, but that alternative sources like leasing has also a high relevance (Frank and Kraemer, 2015).

Leasing is referred to as asset based financing (Burgress, 2002). As 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 (compared to traditional bank lending which will either be unsecured or make use of different types of collateral and typically not physical assets such as equipment which are inherent in leases). 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, as the lessor retains legal ownership of the asset (Bierman, 2005). 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. Contracts, where legal ownership of the asset passes directly to the customer at the start of the agreement, are not considered to be leases.

The ability of SMEs to access finance is important for funding business investment, ensuring businesses reach their growth potential, and for facilitating new business start-ups; a lack of finance can constrain cash flow and hamper businesses' survival prospects (BIS, 2012). Typically, SMEs are not able to raise money directly in the capital markets and are therefore - with regard to external sources - mainly dependent on traditional bank financing, which is itself limited by constraints due to banks' refinancing capacity, their risk appetite and capital adequacy.

Lack of access to finance is the biggest obstacle affecting SMEs, micro enterprises and new firms in developing countries (IFC, 2012). Though it is believed that SMEs play a key role in economic development and make an important contribution to employment and GDP, access to finance remains a key constraint to SME development, especially in emerging economies (Ayyagari, Beck and Kunt, 2007). Access to finance is disproportionately difficult for SMEs in Least Developed Countries (LDCs), with 41 percent of SMEs in LDCs reporting access to finance as a major constraint to their growth and development, as compared with 30 percent in middle- income countries, and only 15 percent in high-income countries (GPFI & IFC, 2011).

While leasing can be traced back thousands of years, the leasing industry has evolved significantly over the past 50 years (Schrothnk, 2010; IFC, 2009). Modern leasing emerged in the 1950s as a specialized financial service industry in the United States and expanded to Europe and Japan in the 1960s, and has been spreading through developing countries since the mid-1970s (Nair, Todd, & Mulder, 2004).

As the alternative sources of funding, leasing can be an effective mechanism for enhancing the Ethiopian economy by providing long-term finance to SMEs (World Bank, 2015). The international leasing performance of annual leasing volume in 2013 was USD 868 Billion (World Leasing Year Book, 2014). According to this explosion, four countries (US, China, Germany and Japan) represented 60% of world leasing volume. US are the principal player in the leasing industry with more than 30% of the world market. On the other hand, the African leasing industry is still in its early stages as the region represents around 1% of world leasing volume in 2012 (The White Clarke Global leasing report, 2012).

Generally, leasing financing is one of several financial products commonly used by SMEs to support growth. Leasing when available is often the entry point in the financial product spectrum for formal businesses seeking equipment financing and typically targets small businesses that are towards the lower end of any sector, particularly those with no credit history and/or no collateral but with strong cash flow. Leasing finance has a strong positive correlation to GDP per capita growth compared to other SME financing options (World Bank, 2008). Presently, leasing industry in Ethiopia is still at the very early stages of development and expected to face huge challenges despite the large potential market in the country.

1.2 Background of the Company

Development Bank of Ethiopia (DBE) is one of the state owned financial institutions engaged in providing short medium and long term credits over century. The Bank has been playing central role in providing the overall economic development of the country since its establishment. DBE's distinguishes feature is its "project" based lending tradition. In long years of existence, DBE has established recognition at national and international levels. Nationally, it is the sole Bank with reputable experience in long term investment financing. Internationally, and it is recognized as an important on leading channel for development program financed by bilateral and/or multilateral sources.

The Bank also earned net profit of birr 367 million during the year under review. Looking into the trend of net of DBE; Birr 681.4 million in 2015, Birr 373.5 million 2016, Birr 323.85 million in 2017 showing a declining trend. In 2018/19 budget year the Bank plans to approve birr 12.7 billion, disburse birr 7.8 billion, collect birr 6.9 billion in project and lease financing services (DBE Annual Report, 2017).

According to the report of National Bank of Ethiopia report to the parliament, the None-performing loan (NPL) of DBE has reached 39.5 percent as of January 2019 (Mereja.com 2019). The worst target set for NPL of commercial and DBE is 5 percent from the total outstanding loan where the DBE's NPL has significantly raised above the limit.

1.3 Statement of the Problem

Following the nation's GTP-II (2015/16 – 2019/20), the Bank (DBE) has set a stretched plan particularly of credit operation project financing with special focus on lease financing program to SMEs because of its pervasiveness to youth and women, and prospect of changing the livelihood of same while contributing to GDP (DBE annual report 2017). However, it achieved only 9% (Birr 0.51 billion) performance relative to plan target of Birr 5.7 billion. Lack of SME‘s access to finance alternatives impact its growth and other linked contribution of SME. To address easy access of SME finance alternative the Government has put high emphasis in GTP II. Some of the alternatives to enhance easy access of SME to facilitate lease financing their by formulate different proclamation, directives, regulation and policies. Since SME hardly have collateral for their financing needs, lease financing replace as an alternative source of financing. Other effort of the government is finding source of fund by contracting with international development. There are large SMEs in Ethiopian that are not using financial service offered by regulated financial institution. According to the World Bank Enterprise survey (2011), 31.1 percent of firm identifies access to credit as a major business constraint in Ethiopia (compared to 40.8 percent in SSA).

To bridge financing gap in particular and stimulate economic development in general, there is no doubt that individual countries, both developed and emerging economies, are trying to develop different mechanisms of accessing finance (IFC, 2005). Among the alternative that bridge the gap or create range of financial products or sources of funding and boosting economy, leasing can be an effective mechanism by providing long-term finance to SMEs (World Bank, 2015). Therefore increases the range of financial products in the marketplace provides a route for accessing finance to business.

As part of the support to NBE, it has signed an agreement with the IFC for assistance and they identified the key gaps that exist in the leasing sector. Among the key gaps to be addressed are lack of capacity to supervise and regulate the leasing sector and the lack of know-how in leasing at the leasing companies that have been recently formed by government support. Legal and regulatory gaps (taxation, investment, accounting etc.) other gaps like : lack of appropriate management information systems (MIS), lack of funding, and lack of leasing awareness by the players in the leasing eco-system that includes the potential lessor, lessee, and the supplier are identified. Still these gaps are not completely solved and the study tried to assess the reason why continue these gaps and tried to suggest the solutions (Helen Tedla 2014).

In different countries of the world (India and Zambia) Studies conducted to indentified that the leasing industries commonly faces challenges such as: resource crunch; lack of proper and integrated accounting standards; lack of appropriate legal and regulatory infrastructures; absence of financial education or financial awareness of the local population; and inadequate supply chain relationships (Brahmaiah,1992; Aloysius & Lubinda, 2013).

Ethiopia's leasing sector is at an infant stage, currently characterized by inadequate regulatory and legal framework and little know-how of leasing operation by potential key players and by NBE, the regulator (Helen 2014). To-date, renting of equipments is more common, typically in the construction sector. Leasing was limited to a few larger microfinance institutions that leased for example, small irrigation equipments and beehives, typically to farmers, with co-operatives co-signing. The slow development of the leasing sector to-date may be due to the uncertainty and lack of clarity surrounding permissible leasing modalities and the authority that mandates the activity in general (Helen 2014).

Leasing sector is recently experiencing positive developments. There is a growing interest by the government and NBE, as well as by private sector players, to integrate leasing as a crucial instrument to address the gap in access to finance and meet economic growth targets.

An enabling environment for leasing typically requires appropriate laws and regulations, in terms of taxation, operation and ownership, as well as demand and supply of leasable assets, leasing operation knowledge by leasing companies, suppliers and potential lessees.

The present state, March of 2019, Ethiopia's leasing regulatory framework has provided with seven directives issued recently by NBE, following the issuance of an amended proclamation on leasing. These directives address minimum paid up capital requirements, operational modality, Limit on Capital goods finance Exposure to a single lessee, Manner of financial and operational reporting, capital adequacy ratio requirement, penalty for failure to comply with regulatory requirements, and licensing requirements. In addition, Asset Registration policy for leasable assets has been added recently to support the regulatory framework. More policy, procedures, and operational guidelines also added by DBE. On the other hand, the study investigated the challenges the Bank has faced in its daily operation and the adequacy of the regulatory framework formulated from various stakeholder for enabling lease financing.

Presently, leasing industry in Ethiopia is still at the very early stages of development despite the large potential market in the country and Concerning to Ethiopia lease financing research case only few local studies done previously by Asfaw (2016) and the sector needs further study to identify the major practical challenges and to dig out the obstacle that makes finance leasing under developed and point out the bright prospects exist in the market to invite potential investors. Now the study focused to identify the major challenge of lease financing in DBE (Development Bank of Ethiopia) and possible prospects which provide lease finance for SMEs. And even if there is great government attention to the leasing financing the sector is till underdeveloped and practical challenges were not adequately identified. Moreover, some regulatory framework and policy and procedures has introduced recently from 2017 to 2019 that should be evaluated by this study. Therefore, the study was tried to find these challenges. Besides these challenges the study also tried to assess the market potentials or prospects of lease financing in the current situation of the country.

1.4 Research questions:

Based on the above problem statement, the study tried to answer the following questions:

- What are the lease Financing legal and administrative frameworks?
- What is the awareness and demand level of SME for lease financing?
- How does the leasing laws, regulations and directives affecting SME lease financing are adequate?
- Do the bank’s policies and procedures to finance SMEs reduce the associated costs?
- What are the bank’s credit risk management and bad loan recovery process?
- What are the potential prospects and opportunities that initiate the growth and development of leasing industry?

1.5 Objectives of the Study

1.5.1 General Objectives

The general objective of the study was to identify the challenges and possible prospects of lease financing in Ethiopian.

1.5.2 Specific objectives

This study specifically strives to achieve the following special objectives:

1. To understand the lease financing legal and administrative frameworks;
2. To identify the awareness and demand level of SME for lease financing;
3. To examine the adequacy of leasing laws, regulations and directives affecting the SME leasing business in Development Bank of Ethiopia;

4. To identify whether the bank's policies and procedures to finance small and medium enterprises reduces costs associated with the program;
5. To assess the bank's credit risk management and bad loan recovery process regarding SME lease financing
6. To assess potential prospects and opportunities of lease financing in Ethiopia

1.6 Significance of the study

The results of the study have a great importance for different parties as lease financing is a new phenomenon in Ethiopia. Therefore, the study was expected to provide a better ground for DBE and potential leasing investors, policy makers, practitioners, and lessee firms. And it indicated the market potential for stakeholders which have interest to engage in leasing business. The study also helps for a researcher as standing point who needs to undergo further research on the sector. The study has expected to solve some problems of the leasing sector practice and existing gaps. More or less the study contributes to increase the general awareness of lease and the development of the industry based on some recommendation and finding.

1.7 Scope of the study

The study mainly focuses on the practice and challenges which include financial leasing and hire-purchase in the Ethiopian context. The target study employees of Development Bank of Ethiopia in Addis Ababa working at Head Office, District and Branches. Review of operating leasing practice was not covered in the study, due to the fact that the capital good finance companies (or leasing companies) in Ethiopia are not allowed by law to engage in the business of operating lease. The horizon of the study has limited to assess the activities of leasing company which is DBE, which provide for leasing financing above 1 million ETB for one SME and regulated by the National Bank of Ethiopia.

1.8 Definitions of Terms

Operational Definition

The researcher cited the terminologies that used in the subsequent report along with the research subject.

"Leasee" means a person who, under a lease agreement, obtains capital goods from a lessor and has the right to use the capital goods, against payment of rent for an agreed period of time;

"Lessor" means a person who, under a lease agreement, provides to a lessee the right to use the capital goods in return for rent for an agreed period of time;

''Capital goods" means goods designated as such under the Investment law and directives issued by the Investment Board pursuant to the powers vested in it

1.9 Organization of the Chapter

This paper is organized into five chapters, the first chapter deals with the introduction of the study that is, background of the study, background of the company, statement of the problem, research questions, objective, and significance, definition of terms, scope and limitation of the study. The second chapter discusses the theoretical and empirical literatures about lease financing. The third chapter is about the methodology of the research that is the research design, sampling technique, method of data collection, data collection instruments, method of data analysis and so on. The fourth chapter of the paper presents the findings, Discussions and data analysis. Finally the fifth chapter deals with the conclusion and recommendations of the study.

CHAPTER TWO

2. REVIEW OF RELATED LITERATURE

2.1 Introduction

This section presents the review of related literature in the area of lease financing. It focuses on the concepts/principles, evolution and approaches to leasing as well as Development lease and stakeholder role for lease development.

2.2 Theoretical Review

2.2.1 Lease: Concept and Evolution

While leasing can be traced back thousands of years, the leasing industry has evolved significantly over the past 50 years (IFC, 2009). Modern leasing emerged in the 1950s as a specialized financial service industry in the United States and expanded to Europe and Japan in the 1960s, and has been spreading through developing countries since the mid-1970s (Nair, Todd, & Mulder, 2004). The number of leasing companies in developing countries has been especially increasing during the last ten years. However, such rapid emergence and growing significance of leasing in developing countries has until recently remained largely unappreciated by policymakers in many countries. Policy makers' attentions have been focused on the larger and more visible institutions in financial sectors, such as banks.

Yet, enterprises through the world use leasing to finance vehicles, machinery and equipment. According to ILO (2003), in developed (OECD) countries up to one third of private investment is financed this way, through leasing. Leasing in developing countries took off slowly at first, but during the 1990s the leasing industry in these countries saw spectacular growth, mostly through leases to large and medium enterprises. This growth can to a large extent be attributed to improvements in the legal and regulatory environment for leasing (ILO, 2003). Aloysius and Lubinda (2013) also argued that the remarkable growth of leasing industries in some African countries has been because of a varied number of interventions among which leasing legislative reform is one that contributed to the expansion process of the leasing industry.

Presently, the global leasing performance as indicated in World Leasing Year Book (2014) reported that annual leasing volume in 2012 was USD 868 Billion. According to this report, four countries (US, China, Germany and Japan) represented 60% of world leasing volume.

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 also 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 (Gallardo, 1997; Berger and Udell, 2005).

Leasing in its simplest form is a means of delivering finance, with leasing broadly defined as "a contract between two parties where one party (the lessor) provides an asset for usage to another party (the lessee) for a specified period of time, in return for specified payments." Leasing, in effect, separates the legal ownership of an asset from the economic use of that asset (IFC, 2009).

In Ethiopia, according to the Capital Goods Leasing Proclamation No. 103/1998, leasing means a financing in kind for production and service purpose by which a lessor provides lessee with the use of specified capital goods on financial or operating lease or hire-purchase agreement basis, without requirement of collateral, for a specified period of time and collects in turn a certain amount of installment in periodical payments over the specified period.

2.2.2 Types of Leases

The value of rental as well as risk assessment in lease contract is influenced by the type of lease agreement. Lease authorities share opinion as to the two types of lease; Finance lease and Operating lease-Wright (2004) and Ndu (2004).

The differences between these lease types are reflected in;-

- The accounting treatment of the transaction
- Legal right of the lessors and the lessees
- Price of rentals
- However some authors classified in to 3 main types of leasing:
- Operational lease
- Finance lease, and

- Hire purchase lease.

They generally vary in ownership rights and control of asset rights as well as responsibility for maintenance, damage and insurance. Leasing serves generally all sectors and can be applied for different size equipment.

Table 1: Main Types of Leasing

	Operating Lease	**Finance Lease**	**Hire Purchase Lease**
Ownership	LESSEE does NOT own the equipment; Equipment is returned at the end of rental period.	Ownership remains at LESSOR until the end of Lease period, when LESSEE has an option to buy.	LESSEE ownership increases through the lease period with eventual ownership; similar to a mortgage system.
Payment	LESSEE makes regular rental payment; Does not pay the full value of the equipment over the rental period	LESSEE makes regular fixed payment over an agreed period, paying nearly the full cost of the asset Plus charges over the period of the lease	LESSEE makes payments that increase ownership rights until the payments are complete
Service, Repair, maintenance damage, and Insurance	Responsibility of LESSOR.	Responsibility of LESSEE – all risks usually associated with ownership, although LESSEE does NOT own.	Responsibility of LESSEE – all risks usually associated with ownership although LESSEE does NOT own.
Key Benefits	Enhanced cash flow with lower payments	Same as operating lease; with option to own at end of lease period.	Same as operating lease; Gradual ownership

Source: Helen Tedla (2014)

2.2.3 Essential Elements of Leasing

The Transaction

The transaction of a lease is the granting of economic use of an asset by the owner (lessor) to a second party (lessee) in consideration of rentals being paid by the lessee for a fixed amount for a fixed period of time. The fixed amount and the fixed term (tenor) can be varied if permissible under the terms and conditions of the lease agreement (IFC, 2009).

Parties to a Lease

As parties to the leasing agreement, the lessor, lessee, and supplier can be either legal entities (incorporated) or individuals (sole proprietors).

The Leased Asset

The leased asset must be identifiable and non consumable (that is, the asset is not destroyed or transferred into another form or condition once used and retains its original form during its use while depreciating gradually). In developed leasing markets, the industry has expanded from simple manufactured tangible products into leasing software (usually via software licenses) and also animals such as breeding livestock. Legislation can impose some restrictions on this general rule; for example, to prohibit the leasing of certain articles that are in limited free circulation or withdrawn from circulation (such as designated land plots or natural sites). In general, anything that cannot be owned or held title to cannot be leased, because to act as a lessor one needs to buy the asset first.

Lease Period

The term of lease (tenor) is the period for which the agreement of the lease is in operation. Some finance lease contracts may stipulate that the period of leasing be divided into two distinct parts, the primary and secondary periods of lease. In the primary period, the lessor will recover all of the cost of the equipment plus any fees and interest chargeable. The secondary period may be an option for the lessee to continue economic usage of the asset without taking ownership (where this is possible). During this secondary period, the lessee pays rentals that are much smaller than those paid during the primary period. The primary period is normally non cancelable—that is, neither the lessor nor the lessee may break the contractual terms of the lease as long as both parties are adhering fully to its terms and conditions; the secondary period is normally cancelable.

Lease Rentals (or Lease Payments)

Lease rentals represent the consideration (usually monetary) for the lease transaction; this is what the lessee pays to the lessor. Most financial leases are amortized on the basis of constant payments (lease rentals) over the lease period. Interest rate can be fixed or variable. Finance lease rentals include principal and interest portions. In many cases, financial lease payments may include other costs such as insurance, regular maintenance, and certain tax costs (such as property tax). These payments may be on a "pass-through" basis or otherwise structured.

Rights and Responsibilities of the Parties to a Lease

The "freedom of contract" concept is a cornerstone of leasing parties' rights and responsibilities. The parties to a lease may agree on a different scope of their rights and responsibilities the legislation has to provide the framework that parties should not be allowed to derogate from. The following are the most important principles laws need to address regarding parties' rights and responsibilities to ensure that the legal framework is effective:

- Limitation of lessor's equipment responsibilities and third-party liability.
- Lessee's absolute duty to pay leasing payments.
- Lessee's direct recourse against the supplier.

2.2.4 Rationale and Principles of Leasing

The essence of leasing is the separation of property from ownership (Bruce, 1988). This is further clarified by other authors that the concept of leasing is based on the proposition that income is earned through the use of assets, rather than from their ownership (Fletcher et. al., 2005; IFC, 2009; World Bank, 2000). Leasing focuses on the lessee's ability to generate cash flow from business operations to service the lease payment, rather than on the balance sheet or on past credit history (IFC, 2009). This explains why leasing is particularly advantageous for young companies, as well as small and medium businesses that do not have a lengthy credit history or a significant asset base for collateral. Furthermore, absence of collateral requirement with leasing offers an important advantage in countries with weak business environments.

Because the lessor owns the equipment it can be repossessed relatively easily when the lessee fails to meet lease rental obligations.

Leasing is a rental agreement that extends for a year or beyond, and involves a series of fixed payments. In other words, leasing is defined as a contract between two parties wherein one party (the lessor) provides an asset for use to another party (the lessee) for a specified period of time in return for specified rental payments (IFC 2009). Leasing is, therefore, an alternative to borrowing. In this case, legal ownership and use of an asset are separated. Leasing emerged as an important market for those entrepreneurs who do not have the required funds and lack access to bank finance. Entrepreneurs may also prefer to acquire assets through leasing when this is cheaper than other means of acquiring assets. Leasing is reported to be of high value to those companies that have been newly established and lack startup capital (GTZ 2002).

Lease financing provides manufacturers and producers the use of equipment and machineries without having to pay upfront the full costs of these investment goods. The major thrust of the principles of lease finance is that ownership is not necessary to generate profit. The use of productive assets through ways other than ownership can be equally viable for income generations.

2.2.5 The role and Benefits of Leasing

Generally, leasing fosters economic development and job creation, by providing access to financing to micro, small and medium businesses that often cannot access other forms of financing (IFC, 2009). According to ILO (2003), leasing offers several advantages over other kind of financing. The most important advantages are:

Absence of collateral requirements

The great advantage of leasing is the absence of (or very few) collateral requirements. The equipment itself serves as security because the lessor retains ownership. If the lessee is unable to make payments, the lessor can repossess the asset.

Simpler evaluation

A lease can be concluded more quickly and simply than a bank loan. Rather than looking into the credit history and asset structure of the client, the leasing company only has to make sure that the client has the ability to generate sufficient cash through the leased equipment. Less detailed documentation is necessary, and the appraisal can be processed relatively quickly.

Full finance

Banks usually require from clients that they finance part of the investment from their own resources. Down payments are often up to 40%, thus reducing the amount of the loan. In a lease, 100% of the equipment value is financed and up-front security payments seldom exceed 10%. This enables lessees to retain more of their scarce resources as working capital.

Tax incentives

In many countries the tax system is conducive to leasing. The lessor, as the owner of the equipment, registers the full lease payment (principal plus interest) as income but deducts the depreciation of the asset, usually on an accelerated schedule. The lessee claims the lease payment as deduction from taxable income. The lease term is usually shorter than the economic life of the equipment, so the lessee in fact "depreciates" the equipment more rapidly than if he/she had purchased it. Since both parties benefit from tax relief on an accelerated basis, overall tax payments on the lease are reduced.

No risk of fund diversion

In leasing, the funding provided goes to the purchase of equipment without even passing through the lands of the lessee. This averts the risk that the lessee might use the funds for purposes not agreed upon. It also avoids the risk that the lessee might use the credit to pay back a loan from another financial institution (ILO, 2003).

2.2.6 Sources of Funding For Leasing Companies

As per ILO (2003) an institution offering leasing needs to attract matching resources to finance the leasing scheme. A lessor offering leases with 2 or 3 years lease terms needs medium term financial resources at the liability side of its balance sheet. Leasing companies are generally not deposit-taking institutions – they rely on capital markets for equity and debt. In developing countries the medium-term debt needed to finance the leasing scheme can be difficult to attract.

In the same notion, IFC (2009) asserts that funding is critical to leasing companies. Stand-alone leasing companies have no parent from whom to receive assured funding compared with bank owned leasing companies that have access to funding from the bank. Thus, stand-alone leasing companies without secure financing can find its sources of funding totally disappearing and, even if it can have access to finance, its cost of funds will inevitably rise, not only affecting its profits but also its ability to on-lend at a reasonable cost. To this end, IFC (1996) suggested that leasing companies should be allowed to mobilize term deposits, but not demand deposits.

Many bank-owned leasing companies will have debt-to-equity ratios of 10:1 (or even more) but stand-alone will only be permitted (by their funders) to leverage up to around 7:1 and in their early phase perhaps only 2 or 3:1 (IFC, 2009).

2.2.7 Theories of Leasing

There are several theories/motivations advanced as to why firms engage in leasing. These theories are discussed below:

Agency Costs Theory

The main theoretical explanation for the relationship between the ownership structure and profitability is based on the agency theory, first formalized by Jensen and Meckling (1976). Agency conflicts can arise between bondholders and shareholders and/or between managers and Shareholders and can lead to asset substitution and underinvestment. Smith and Warner (1979) argue that long-term non-cancellable leases (financial or Capital leases) can help mitigate the asset substitution problem because the non-cancellable lease commits the lessee to use the leased asset over the life of the lease contract.

In the presence of risky debt in the firm’s capital structure, equity holders may underinvest by giving up positive NPV investments because the project’s benefits accrue to the existing debt holders and the existing debt load makes it too costly for the firm to borrow in external capital markets. This creates the underinvestment problem due to debt overhang as identified in Myers (1977). Stulz and Johnson (1985) argue that the non- cancellable long-term leases should help mitigate the underinvestment problem due to debt overhang.

However, in case of short term operational leases, agency costs may also arise between lessor and lessee due to the separation of ownership from usage of asset. Since the lessees have no right to the residual value of the asset, they have no incentive to take proper care of it. This probably explains the reason why corporations lease office facilities much more frequently than manufacturing or Research & Development (R&D) facilities.

Robicheaux et al. (2008) examines whether lease financing, used to control the agency costs of debt, is used as a substitute or complement to mechanisms such as corporate governance, managerial incentive compensation used to control agency costs of equity. They find leasing is complementary to governance and incentive compensation suggesting that firms try to control simultaneously the agency costs of debt as well as external equity.

For the purpose of the study at hand, this theory implies that lease financing brings about efficiency on the part of management of the firm, which in turn would be expected to contribute to the financial performance of the firms listed at the NSE.

Information Asymmetry

Myers and Majluf (1984) argue that information asymmetry influences capital structure of firms. They demonstrate that if managers can issue safe debt, the adverse selection problem due to information asymmetry could be reduced. Pecking orders of capital structure arise in their model, where retained earnings followed by safe debt, risky debt and as a last resort equity are used in that order to finance the operations (Donaldson, 1961).

Consistent with Myers and Majluf (1984) one can argue that leasing, being similar to secured debt should also mitigate the adverse selection problem. Gilligan (2004) argues that leasing may reduce adverse selection in durable goods markets by increasing the average quality of used goods offered for sale.

Smith and Wakeman (1985) and Sharpe and Nguyen (1995) found that leasing aids in alleviating financial contracting costs. They argue that financing with a lease may reduce the cost of external funds that arise due to asymmetric information or from agency problems that give rise to costly monitoring as per Smith and Warner (1979) and Ezzell and Vora (2001). By financing via true lease the firm puts the lease obligation on par with other administrative expenses that have higher priority than normal debt. This makes leasing a highly desirable financial contract in the presence asymmetric information as it puts leasing at the top of the pecking order of external financing options.

Moral hazard problem arises because the salvage value of the leased asset accrues to the lessor. This leaves the lessee with little or no incentive to maintain the asset in order to preserve its salvage value. Lessors do recognize these issues and include various provisions in the lease contract such as penalty clauses, metered lease payments to reduce abuse of the leased asset. Chau, Firth and Srinidhi (2006) argue that leases with a purchase option can completely mitigate the moral hazard problem. From the above discussions it is clear that leases help mitigate the asset substitution problem due to agency and costly external financing due to information asymmetry and hence reduce any excess cost the firm could have incurred if they didn't have complete information. Reduction in excess cost will help improve the financial performance of firms listed in the NSE.

Managerial Risk Aversion

Managers are usually less diversified than regular shareholders because managers have their human capital and current and future compensation tied to the firm's performance or value. Flath (1980) and Smith and Wakeman (1985) argue that the ownership structure should affect the decision to lease assets. A higher level of managerial ownership is mostly associated with higher levels of lease financing. Flath (1980) argues that in closely held lessee firms, leasing is more likely as the ownership of capital assets makes reduction of risk through diversification more difficult and leasing mitigates this concern by allocating usage rights of the underlying asset to the lessee while leaving ownership rights with the lessor.

Leasing reduces the concentration of wealth and facilitates more efficient allocation of risk bearing by shifting ownership risk from risk-averse lessees to less risk-averse lessors. Mehran, Taggart, and Yermack (1999) provide empirical evidence that CEO stock ownership, proxied by the fraction of common shares owned by firm's CEO, has significant positive effect on lease financing. Mehran et al. (1999) argue that when CEOs have larger ownership stakes, their interests are more closely aligned with shareholders and also have more control over the firm. Thus, CEOs with large equity ownership use more leasing in order to reduce exposure to technological obsolescence and other asset- specific risks.

Smith and Wakeman (1985), argues that in addition to managerial stock ownership, managerial incentive compensation can affect the incentives to lease. For example, a manager whose bonus depends on the return on invested capital could argue in favor of leasing rather than purchasing property, plant and equipment as the denominator in the performance measure could increase drastically with purchasing. Robicheaux et al. (2008) offer empirical evidence that firms with higher CEO stock ownership and option compensation use more lease financing.

2.3 History of SME Lease Financing in Ethiopia

DBE lunch lease financing in Ethiopian on October 2016 and it is conducting periodical amending lease financing policy, procedures or/ and guidelines. Even though the outstanding loan of DBE has reached Birr 33.82 billion in 2017, lease financing for SME only registered Birr 0.51 billion.

In accordance with the Government Micro and Small Enterprise Development Strategy, "Small Enterprise" under the industry sector is defined as an enterprise operates with between 6 and 30 employees including the owner and its family; and its total assets worth between Birr 100,001 and Birr 1.5 million excluding the value of land and building; "Medium Enterprise" under the industry sector is defined as an enterprise operates with above 31 employees and its total assets worth above Birr 1.5 million excluding the value of land and building.

According to Ethiopian Growth and Transformation Plan II (GDP II), the economy is projected to increase at an annual average rate of 11% over the plan period from 20115/16 to 2019/20. One of the comprehensive measures such as addressing financial constraints through the regional lease financing institutions and the Development Bank of Ethiopia; alleviating marketing and financial constraints of Small and Medium Enterprises (SMEs); and tackling market access problems of SMEs through creating market linkage with local industries will largely be undertaken to foster the growth, productivity and competitiveness of the sector during the plan period. Moreover, to improve access to finance, the Development Bank of Ethiopia collaborates with other banks to provide sufficient loans to finance projects and provide lease finance to small and medium size manufacturing enterprises. Therefore, SME finance and particularly lease finance has got emphasis in GTP II (GTP II, 2016).

In GTP II, Development Bank of Ethiopia is given the responsibility of providing finance to medium sized enterprises and lease financing services to medium and large enterprises in the country (Wolday A. William M., Fasika J. 2016).

According to the governments' performance assessment of the first three years' implementation of the MSE development strategy, the growth and expansion of the priority or growth-oriented sectors/enterprises, particularly in the manufacturing sub-sector, was far below the planned targets. Lack of financial resources to buy machinery and related investment materials were identified as a key constraint limiting the engagement of MSE operators in the manufacturing sub-sectors. To address this issue, the government took drastic measures by establishing five lease finance companies in the four regions (Oromia, Amhara, SNNP and Tigray) and Addis Ababa city administration, and allocated a 2 billion Birr bank loan. However, implementation of lease financing facilities by lease companies took much longer than expected. (Wolday A. William M., Fasika J. 2016).

A lease financing project targeting some 3000 entrepreneurs operating Small and Medium Enterprises (SMEs) engaged in manufacturing industries is set to provide USD 276 million at the end of 2019/20 (Berhanu 2017). The lease financing project is providing the said amount of money for direct machinery purchases and leasing purposes via the DBE. The balance was also be set aside for soft and technical skills development and other components. However, DBE has received 1,623 lease financing applications by SMEs and approved 780 of them as of April 2018. Since the establishments of the bank, around 132 projects have been executed using lease financing service. Out of the target Birr 5.7 billion, only some Birr 1.47 billion has been disbursed in the form hire purchase (Yonas 2018).

Several concurrent actions are being taken by various stakeholders and the federal and Regional governments to deal with natural and growth related of SME problems. Other than the effort being made to address inadequacies in the area of management through continuous training, especially for small and medium sized projects (SMEs), measures are also being put in place to alleviate the acute financial problems of enterprises for capital goods through such measures like access to improved Machinery, Equipment and Accessories (MEA) in order to improve productivity and advance the production of quality of goods. (Development Bank of Ethiopia lease financing procedure manual, 2015)

The major and eye-catching steps taken by the federal government in this respect include the enactment of Proclamation no. 807/2013 on Capital Goods Leasing Business (actually an amendment to proclamation no. 103/1998); Directive no. CGEB 102/2013 for the Licensing of Capital Goods Finance Service by the National Bank of Ethiopia(NBE); the Capital Goods Finance Service Modality issued by the Federal Micro and Small Enterprises Development Agency; Directives N0. CGFB/07/2017 for minimum paid up capital requirements, for operational modality; Directives N0. CGFB/09/2019 for Limit on Capital goods finance exposure to a single lessee, Directives N0. CGFB/03/2016 for manner of financial and operational information reporting; Directives N0. CGFB/04/2016 for capital adequacy ratio requirement, and Directives N0. CGFB/06/2017 for penalty for failure to comply with regulatory requirements, and licensing requirements.

The government measures support those investors who have the desire, knowledge and profession to participate in various investment activities but could not act due to lack of capital and collateral through creating an enabling environment for the establishment of alternative sources of financing (Development Bank of Ethiopia lease financing procedure manual, 2015).

In order to accelerate the growth and development of SMEs by facilitating access to finance and availing working equipment and machineries Development Bank of Ethiopia (DBE) is one of a specialized financial institution. It was established to promote the national development agenda through development finance and currently operates on the basis of a project finance business model, in which it supports projects with loans and technical assistance in selected high-priority sectors. As a development finance institution, DBE is well placed to serve the financing requirements of SMEs. In relation to the proposed World Bank SME Finance Project to facilitate sustainable provision of lease finance and working capital to SMEs in Ethiopia DBE is expected to play a key role in management of the proposed credit facility, both as a wholesaler (lending to other financial institutions for on-lending to SMEs), and as a retailer (direct support to SMEs). In retail leasing, DBE plans to provide lease finance to SMEs for contracts greater than ETB 1 million through its regional branches. DBE started with one head office, five regional offices and branches. According to the new Leasing Finance Policy for SMEs, DBE regional offices can appraise and authorize SME lease financing from ETB 1 million to ETB 30 million(world bank).

The five licensed lease companies supply finance for contracts less than ETB 1 million. Of which two are based in Addis (Addis Capital Goods and Oromia Capital). In Ethiopia, the leasing companies are expected to provide lease finance for machineries and equipment to the priority areas such as: (a) textile, garment, leather and leather products; (b) metal and wood works;(c) agro-processing, including dairy and poultry equipment; (d); construction machineries;(e) irrigation;(e) wet and dry coffee processing; (f) post-harvest grain processing including seed cleaning equipment; and (g) freight transporters from fields to market centers and warehouses, (h) farm and non-farm cooperatives, unions, and model farmers (IFC,2016).

Government has given responsibility to Development Bank of Ethiopia to provide lease financing for Small and medium Enterprises in order to alleviate financial problems of these enterprises. In pursuit of this objective the bank has officially began SME Lease financing on October 2016. Currently it is only Development Bank of Ethiopia that engages in SME Lease financing in Ethiopia. SME lease financing is the new and infant mode of financing in the country as well as in the specific company which is Development Bank of Ethiopia. In addition to what literatures show about Bank's SME lease financing challenges, annual report of Development Bank of Ethiopia regarding small and medium lease financing shows that the performance of the directorate was under achievement. According to Development Bank of Ethiopia fourth quarter and annual lease financing activity report as of June 30, 2018, the amount planned to be disbursed in the quarter under review was Birr 1.23 billion while the actual disbursement is Birr 496.84 million. Thus, only 40% of the plan is performed whereas the planned annual disbursement was Birr 3.53 billion with actual annual disbursement of Birr 1.39 billion performing 39%.

2.3 Trends/Lessons of Other Countries Lease Financing

Leasing in Russia: Many MSMEs in Russia struggle with inadequate access to the medium or long- term financing to invest in newer, better technologies and improved equipment as well as to finance agricultural production. The development of finance leasing as a complementary tool to bank loans has provided an additional solution for financing major capital investments and has significantly expanded the available pool of medium and long-term capital to MSMEs. The main tax advantages of leasing in Russia are the flexibility to record an asset on either the balance sheet of the lessor or lessee, accelerated depreciation of the asset up to a factor of 3. (not exceeding 3 times the relevant depreciation rate), which reduces property taxes, as well as the ability of lessees to record the full lease payment as an expense item, thereby lowering the taxable profit.

Leasing in Ghana: The leasing industry in Ghana has experienced significant growth, primarily driven by bank lessors. At the end of 2007, there were 14 leasing companies in Ghana which included 5 non-bank lessors and 9 bank lessors. An adjustment to the banking regulations which permits banks to engage in leasing without acquiring a special license has contributed to the increase in the number of banks with leasing operations.

Leasing in Serbia: The International Finance Corporation's (IFC) Southeast Europe Enterprise Development Facility (SEED) facilitated the development of financial leasing in Serbia. The programmer consisted of legislation development and market development (Malhotra, 2007). An assessment of all laws related to financial leasing was conducted in conjunction with government authorities, commercial banks, and SMEs to determine whether separate leasing legislation was required or whether amendments to various pieces of legislation would be sufficient. A market research study was conducted which involved the commercial banking sector and SMEs which indicated strong interest in leasing arrangements (Malhotra, 2007). During the market development phase, SEED focused on capacity-building activities that promoted financial leasing to all relevant parties. These consisted mostly of technical assistance and training aimed at key local stakeholders, such as commercial banks and other financial institutions as potential lessors and local business service providers and SMEs as potential clients.

2.4 Empirical Review

Watson et al., (2004) Empirical study in Egypt about the challenges and opportunities of leasing for SME indicates regulatory and legal deficiencies were one of the main reasons hindering the development of the leasing market there despite the suitability of the economic conditions. Lack of funding and absence of guarantees still represent an obstacle towards the development of the leasing market. The study find that there is a good potential for lease market development there are also still several constraints, both on the leasing as well as the SME levels.

Study by Bashar, 2000 on the nature of legal relationship between the parties in the process of leasing with the objective to present the importance of financial leasing contracts in supporting the national economy. And in particular to developing countries for their limited financial resources to gain access to technical development and the advancement of the industry by acquiring the necessary equipment to run projects for the production of goods, and remove them from the process of economic recession to prosperity and integration into the circle of producing countries. The study point out two legal relationships, these are: relationship between the supplier and the lessee, and relationship between the lessee and the lessor. The most important results of this study is that leasing contracts are the most important financial contracts, which play an important roles and essential to the national economy, especially in developing countries.

Study by Sakhr, 2004 to address the problem of leasing from the legal point of view and importance of leasing law in Jordan. The researcher elaborated the importance of developing leasing law which contribute to solve many of the issues that govern the leasing contracts, where a special legislation has been issued which deals with risks taken by the lessee, it is the same legislation developed by international accounting standards. The study main results were:

- The leasing contract should be relatively recent and promote the national economy.
- The lease payment is a key element in the financial leasing contract
- The standard leasing principle in Jordan is that risk is always taken by the lessee.

According to (Helen, 2014), Ethiopia leasing sector is at an infant stage, currently characterized by inadequate regulatory and legal framework and little know-how of leasing operation by potential key players and by NBE. To-date, renting of equipment is more common, typically in the construction sector. Leasing was limited to a few larger microfinance institutions that leased for example small irrigation equipment and beehives, typically to farmers with co-operatives co-signing. The slow development of the leasing sector to-date may be due to the uncertainty and lack of clarity surrounding permissible leasing modalities and the authority that mandates the activity in general. Leasing sector is recently experiencing positive developments. There is a growing interest by the government and NBE, as well as by private sector players, to integrate leasing as a crucial instrument to address the gap in access to finance and meet economic growth targets. An enabling environment for leasing typically requires appropriate laws and regulations, in terms of taxation, operation and ownership, as well as demand and supply of leasable assets, leasing operation knowledge by leasing companies, suppliers and potential lessees.

As empirical study indicates lease financing is at its infant stage of development in Ethiopia and has potential prospects for growth even it encounters so many challenges like law contradiction, there is no mechanism of easy repossession of leased asset (particularly for hire-purchase product) without judicial process. Besides those and other challenges lease financing in Ethiopia has high market potential for growth. Leasing as an alternative source of financing has many benefits for SMEs in Ethiopia. It reduces the collateral requirement, one of the major challenges of SMEs to have access to finance, since the equipment itself serves as a security.

Asfaw (2016) has done on assessment of Lease Financing in Ethiopian on Five regulated lease financing companies and the results of his finding indicates the major challenges of the lease finance sector in Ethiopia include: lack of availability of low cost and sustainable funding; lack of clarity on interpretation of tax incentives provided by law; lack of leasing expertise in the market; existence of inadequate supply chain linkages as well as procurement hurdles; existence of limited domestic suppliers; and absence of specialized leasing training center .

2.5 Research Gap and Conclusion

Moreover, Recently the Ethiopia has enormous growth in the leasing of business assets for Leasing has play a vital role to meet up the financial needs of various sectors of an economy and thus contribute to the economic development of the country as well as to the deepening of the country's financial system. Leasing business in Ethiopian has been developed within a very short period of time and its further development is increasing continuously with lots of unfavorable on the sectors as well. The present state, March of 2019, Ethiopia's leasing regulatory framework has provided with seven directives issued recently by NBE, following the issuance of an amended proclamation on leasing. Hoverer, leasing industry in Ethiopia is still at the very early stages of development despite the large potential market in the country and Concerning to Ethiopia lease financing research case only few local studies done previously by Asfaw (2016) and the sector needs further study to identify the major practical challenges and to dig out the obstacle that makes finance leasing under developed and point out the bright prospects exist in the market to invite potential investors.

So, this study has made an attempt to bridge the gap and highlighted the major challenge of lease financing in DBE (Development bank of Ethiopia) and possible prospects which provide lease finance for SMEs, which contributes for the development of leasing financing in Ethiopia.

CHAPTER THREE

3. RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

In this chapter, the research methodology used is briefly discussed. It describes the research methodology, research design/type, sampling design, source of the data, data collection method, data collection instrument, method of data analysis, validity and reliability, and research ethics followed.

3.2 Research Methodology

In order to achieve the objective of the study and answer the research questions, mixed research approach was adopted to examine the challenges and prospects of SME lease financing in Ethiopian the case of Development Bank of Ethiopia to converge across qualitative and quantitative methods (triangulating data sources). Employing this approach was used to neutralize or cancel the biases of applying any of a single approach and a means to offset the weaknesses inherent in a single method with the strengths of the other method (Creswell 2003).

In this study, Concurrent procedure was employed to triangulate quantitative and qualitative data to provide a comprehensive analysis of the research problem (Creswell, 2003). Moreover, the researcher has collected both forms of data at the same time during the study and integrated the information in the interpretation of the overall results.

3.3 Research Design

By taking the research objectives and nature of the study into consideration, descriptive and explanatory research designs were used. As stated by Kothari (2004), descriptive research studies are those studies which are concerned with describing the characteristics of a particular individual, or of a group. Therefore, descriptive research was selected for this study. Hence, in this study, it was used to describe the demographic and general information of the respondents and enterprise. Explanatory research design was also used to gain new insights about the leasing phenomenon in the country. The study was used mainly a cross-sectional research survey in which the collection of information from the respondents is carried out at a single point in time.

3.4 Research Method

3.4.1 Sample Design

The researcher used purposive sampling based on the requirement of information from the company staffs for the selection of branches. Branches of DBE and its employees in Addis Ababa was selected purposively to get full information and to increase the strength of reliability of the research in addition to the information obtained from the head office which was purposively selected. The staffs of head office, District and branches were also selected purposively. The researcher plan to use purposive sampling was just to get genuine information and the quality of data which gather for the analysis increase the research validity.

3.4 .2 Population and Sample Size

The population of the study covered employees of DBE in Addis Ababa. The central focus of the study was on the DBE as the data from human resource indicates DBE has 211 clerical staffs on lease financing wing of the bank: at head office one department, one Addis Ababa district and four City branches. From these populations the sample respondents were selected to answer the prepared questions with 95% confidence level and an error limit of 5% according to Yamane formula. $n= N/ (1+N(e^2))$. Hussey (1997:226) says no survey can be fee from error and error limit less than 5% and confidence level of higher than 95% can be regard as acceptable. Therefore, using Yamane (1967:886) simplified formula proportion we can get a sample size of 138.

3.4.3 Data and Collection Instruments

The study employed both primary and secondary data. Primary data was collected through questionnaire and interviews. Secondary data source was collected from various available publications, article of association of companies, proclamations, Directives, regulations, brushers and banks reports. Besides, crucial information and published documents related to legal and regulatory framework of leasing were collected from the National Bank of Ethiopia, Ministry of Trade and Ethiopian Investment Commission. The detail descriptions of the data collections instruments are presented as follows:

3.4.3.1 Questionnaire

In order to gather primary source data from respondents, a questionnaire was developed incorporating background information of respondents and major areas that include a questionnaire that address a research questions. The five point Likert rank order scale measurement was prepared to the respondents to indicate their level of agreement with the following statement ratings: Strongly Agree (SA; or 5), Agree (A; or 4), Neutral (N; or 3), Disagree (D; or 2) and Strongly Disagree (SD; or 1).

3.4.3.2 Interview

Key informant interview was conducted using purposive selection of senior staffs to get good insight of the leasing practice of the Bank. The interview was allowed the researcher to get some degree of flexibility at the time of interviewing for the pursuit of unexpected line of inquiry which arises at the study progresses. Questions in the interview checklist were constructed based on the review of literature.

3.4.3.3 Document Review

The Development banks reports, company policies and manuals, and other laws, regulations and directives related to leasing business were referred.

3.4.4 Method of Data Analysis

The data collected through the questionnaires was analyzed through descriptive statistics that involves frequency distribution, percentages, cross tabulation, bar chart and/or pie charts. The SPSS (Statistical Package for Social Science) was used to generate the data statistics. For this study, descriptive statistics was chosen because of its simplicity and clarity to draw inferences. Averages, percentages, diagrams, and frequencies were used to analysis the research report. The secondary data was also analyzed quantitatively while the primary data was obtained through open-ended questionnaires, key-informant interview and document review was interpreted qualitatively and summarize in line with respective theme against the background of the research questions and objectives.

3.5 Validity and Reliability

Reliability and validity are the essential criteria for assessing the accuracy and precision of the quantitative aspects of this research.

3.5.1 Validity

Validity can be divided into external validity and internal validity (Creswell, 2003). External validity is the researcher’s ability to draw correct inferences from the sample regarding other persons, other settings and past or future situations (Creswell, 2003), i.e. the data's ability to be generalized to other persons, settings and times. Adopting a representative sample is a basic consideration for achieving external validity. It is difficult to generalize the findings unless the drawn sample is representative of the population.

Internal validity is the researcher's ability to draw sound inferences from the data in an experiment (Creswell, 2003).

3.5.2 Reliability

Reliability in form of Cronbach's alpha helps to access the goodness of measure. The recommended minimum acceptable level of reliability "alpha" is 0.60 using the Hair et al (1998) criterion, and greater than 0.50 using the Nunnally (1978) criterion.

Before undertaking the analysis to examine the effect of the independent variables on the dependent variable, the researcher undertook the reliability test to assure the research instruments was reliable. Reliability is the extent to which a measurement gives results that are consistent and fundamentally concerned with issues of consistency of measures (Bryman and Bell, 2003). Cronbach's alpha is a measure of internal consistency, that is, how closely related a set of sample items are as a group. It is considered to be a measure of scale reliability. A "high" value for alpha does not imply that the measure is one-dimensional. Technically speaking, Cronbach's alpha is a coefficient of reliability (or consistency). According to Hair, et al., (2006), if α is greater than 0.7, it means that it has high reliability, 0.5 is sufficient, and if α is smaller than 0.3, then it implies that there is low reliability.

Accordingly, the overall Cronbach's alpha result of the 52 items in the study was 0.855 which is higher than the minimum alpha value set as acceptable (i.e. 0.70). The Cronbach's alpha result of each item used in the questionnaire is shown on the following table.

Table 3.5.2: Cronbach's Alpha Test for Reliability

Reliability Statistics		
	Cronbach's Alpha	N of Items
Over all Reliability	.855	52

Source: Own Survey Result, 2019

3.6 Research Ethics Considerations

As this study required the involvement of persons, (businessmen and employees) different ethical issues was addressed. The consideration of these ethical issues has necessary for the purpose of ensuring the privacy of participants as well as the confidentiality of respondents' data. In order to secure the consent of the selected participants, the researcher has clarified the purpose of the study and the role of participants in completion of the study. The researcher also informed participants that their participation in the study was based on their willingness, and the idea and comments they raise are highly honored and kept confidential. In the final result of the research paper personal information was not included, only the summery of relevant data that helped in answering the research questions was incorporated.

3.6.1 Permission

Before collecting data, written permission is required from respective Department to conduct this research, in order to ensure that it is a legal exercise.

3.6.2 Confidentiality and Privacy

The information concerning respondents was kept in a confidential manner. Respondents were assured that their names were dealt with in the strictest confidence. Respondents also informed during the data collection as their information was kept confidential.

3.6.3 Voluntary Participation and Informed Consent

The principle of voluntary participation was explained to the respondents and they should be informed that they have the right to withdraw from the study at any time. Therefore, the researcher informed the respondent/interviewees both by written and verbally.

CHAPTER FOUR

4. DATA ANALYSIS AND DISCUSSIONS

4.1. Results

The main objective of the study has been to examine the challenges and prospects of lease financing on Small and Medium Enterprise. In order to meet the objective of the study, the data that were gathered from the primary source using questionnaire and interview was analyzed, presented, and interpreted in this section.

4.2 Survey Results

4.2.1 The Response Rate

The questionnaires were physically distributed to staffs of Development Bank of Ethiopia Head Office and branches in Addis Ababa City under the division of lease financing. From the total of 138 questionnaires 125 were collected and the remaining 13 (10%) were not responded. The response rate of the collected questionnaires was (91%); however, out of these, due to incompleteness and missing values only 122 (88%) were usable for further analyses and the remaining 3 (2%) were discarded. According to Rubin & Babbie (2010), a response rate of 70% is "very good" for further assessment. Therefore, in this case response rate of 88% is very significant. On the other hand, four people have participated on the interview.

Table 4.3: Questionnaire Response Rate

Sample Size	138
Collected	125
Remain uncollected	13
Discarded	3
Usable	122
Response Rate	**88%**

Source: Own Survey Result, 2019

4.2.2 Demographic Characteristics of the Respondents

Demographic characteristics are indicators of performance in any organization and are basis for research questionnaire turnout. Even though demographic characteristics are not having great influence on this study, the researcher considers some of them which are believed to have relation to the study. Hence, the demographic characteristics of gender, age, education, work experience and current job position respondents were emphasized.

Analysis of respondents profile shows that gender wise 73% of respondents were male and 27% were female. On the other hand, as displayed in the table below, significant part (47.5%) of the respondents exist within the age of 36 – 45 years, while 36.9% are between 26 – 35 years, 9% were between 46-55 years and the remaining 6.6% are above 56 years. (See table-4.2 below).

Table-4.5.1: Profile of the respondents

		Frequency	Percent
Gender	Male	89	73.0
	Female	33	27.0
	Total	122	100.0
Age	26-35	45	36.9
	36-45	58	47.5
	46-55	11	9.0
	>56	8	6.6
	Total	122	100.0
Education	Masters Degree and Above	18	14.8
	First Degree	98	80.3
	Diploma	6	4.9
	Total	122	100.0
Experience	less than 5 Years	32	26.2
	6-10 Years	13	10.7
	11-15 Years	5	4.1
	16-20 Years	50	41.0
	Over 20 Years	22	18.0
	Total	122	100.0
Current position	Junior loan officer	23	18.9
	Loan Officer	48	39.3
	Senior Loan Officer	43	35.2
	Manager	6	4.9
	Director	2	1.6
	Total	122	100.0

Source: Own survey Result, 2019

Regarding educational background of the respondents, 80.3% of the 122 respondents were first degree holders, 14.8% of them are having educational qualification of master's degree and while the remaining 4.9% were diploma holders. This figure explains the study has got a proper input from well-educated staffs and managers as well as directors of Development Bank of Ethiopia. When we look at work experience of the respondent from the data, greater portion of the respondents with 41.0% have served in the banking industries with work experience of 16-20years while 26.2% have work experience less than 5 years, 18% above 20 years, 107% between 6-10 years and the rest 4.1% were between 11 – 15 years. This indicates that the study has relied on well experienced employees and as well as young staffs of Development bank of Ethiopia, under Small and medium enterprise lease financing directorate. However, lease financing experience is a short history in Ethiopian context as lease financing practice has started in the second half of 2016/17.

On the other hand, with regards to the staffs current positions, 39.3% were loan officers, 35.2% were senior loan officers, 18.9% were junior loan officer, 4.9% were division managers and team leaders while 1.6% were at director level.

4.2.3 Challenges and Prospects of Lease Financing

4.2.3.1 Lease Financing Legal and Administrative Frameworks

In this section the study was aimed to identify the lease financing legal and administrative frameworks with regarding to SME Lease financing. Thirteen proper questionnaires were asked in order to get the extent of the agreement from respondent. These questions mainly aimed at identifying the challenges that the bank may face during its financing activity regarding the SME lease financing program. As it can be observed from the following table the question have addressed the issues related to selection criteria, availability of loan able fund, management of the bank regarding the SME lease financing program, availability of shelter for users of the program through government bodies, availability of proper capital goods supplier and obstacles to the bank's involvement with SME regarding SME Lease financing.

Table 4.5.2 Descriptive statistics about the lease financing legal and administrative frameworks with SME Lease financing

	N	Minimum	Maximum	Mean	Std.

					Deviation
The bank's selection criterion for SME is the client's total asset over capital.	122	1.00	5.00	3.5000	1.02247
The bank has sufficient long term fund to support its SME Lease financing program.	122	2.00	5.00	3.5574	.96251
The bank has a separate unit managing the banking relation with SMEs.	122	1.000	5.000	3.23770	1.012756
There is Tax incentive by tax authority for SMEs who are users of the SME lease financing program.	122	2.00	5.00	4.2754	.84758
There is adequate shelter prepared by government for SMEs who are user of SME Lease financing.	122	2.00	4.00	3.2787	.83579
There are sufficient and proper suppliers of capital goods to buy for approved SME lease financing applicants.	122	1.00	5.00	2.2459	.87492
The bank have a sector-specific focus in dealing with SMEs	122	1.00	5.00	3.7213	.86495
The bank have a specific geographic focus in dealing with SMEs	122	1.00	5.00	3.7049	.92431
The following factors are obstacles to the bank' s involvement with SME regarding SME Lease financing: . Macro-economic instability.(like inflation, currency fluctuation)	122	1.00	5.00	4.3115	.64388
· Domestic regulations	122	1.00	5.00	4.3279	.64849
· Poor quality of Financial statement of SMEs	122	1.00	5.00	4.3525	.61553
· Lack of sufficient demand (absence of SMEs) or Available customers are not credit worthy.	122	3.00	5.00	4.3443	.49411
· Lack of knowledge about SME lease financing.	122	1.00	5.00	4.3115	.56161

Note: 1-Strongly disagree; 2-Disagree; 3-Neutral; 4-Agree; 5-Strongly agree

Source: Own Survey result, 2019

According to the survey for the question regarding to selection criteria almost all respondents have agreed with 40.2% Agree and 15.6% strongly agree that the selection criteria for SME is based on client's total asset over capital. It shows that more than half of the respondent be in agreement that the bank selects SME lease financing based on its asset than capital.

This indicates that the bank select SME based on the total asset than capital of the applicant SMEs which is similar to the conventional way of bank service.

For the statement that says the bank has sufficient long term fund to support its SME lease financing program, respondents have 45.1% agreed and 21.3% strongly agreed. This implies that the bank have sufficient loan able fund to support its SME lease financing program. This statement is supported by the annual report of the bank as lease financing target was not met and the fund for SME come external sources such as International Development association (IDA) and European Investment Bank (EIB).

Respondents were asked for their level of agreement regarding tax incentives provided by the tax authority for the SMEs and agreed by indicating their answer as 45.9% agreed and 28.7% strongly agreed with mean value of 4.3 and standard deviation of less than one. This shows that there is tax incentive for SMEs.

The respondents were asked whether the government prepare shelter for SMEs who want to use the SME lease financing and they have responded as 52.5% agreed while 23% Neutral, 23.5% were disagreed. Since the standard deviation is less than one, the respondents are closer to one another the cumulative level of agreement shows that there is shelter provided by government to SMEs.

The respondents were asked whether there are sufficient and proper suppliers of capital goods to buy for approved SME lease financing applicants and the responded as 58.2% disagreed,13.6% strongly disagreed, while 21.3% Neutral, 4.5% were agreed. In analyzing whether the bank has geographic focus in providing loan for SMEs almost all respondents have shown their agreement. This is evident that bank has geographically segmented to serve its target by district.

For the assessment of the sector wise focus significant portion of respondents have been agreed while some of them are indifferent. Among, 49.2% agree and 16.4% strongly agreed while the remaining 0.8% and 8.2% were strongly disagreed and disagree, respectively.

4.2.3.2 Adequacy of Leasing Laws, Regulations and Directives

Ethiopia has a leasing industry specific legislation. Issued in 1998, the first leasing proclamation, i.e. Capital Goods leasing business proclamation No. 103/1998, provides a legal framework of the leasing business. However, it can be argued that this proclamation has not achieved its objective for over the last 16 years or so. Because, except for operating leasing, financial leasing and hire-purchase were not practically in existence.

Although microfinance institutions are allowed to provide financial leasing services by the Micro-financing business proclamation No. 626/2009, this product has not been delivered in a considerable and professional manner, due to lack of leasing skills.

Thus, in order to address this gap as well as create alternative sources of financing for SMEs through establishment of specialized leasing companies in a manner that support the manufacturing sector, the government of Ethiopia has issued amendment proclamation No. 807/2013, which is applicable to the leasing business together with the former proclamation.

In this sub topic the study was aimed to examine the extent of adequacy of leasing laws, regulations and directives affecting the SME leasing business in Development Bank of Ethiopia. In doing so seven question have prepared and distributed to respondents regarding this topic. The questions tried to address issues like adequacy of regulatory frameworks, clarity of leasing laws in defining responsibility of the two parties lessor bank and lessee SMEs, effects of prudential regulatory, effects of government transformation plan, adequacy of directives from NBE regarding to SME lease financing and effects of change in leasing laws on applicants. The study also attempts to address the question whether the overall legal and regulatory environment is favorable and supportive to the bank in dealing with the SME lease financing program.

Table 4.5.3 Descriptive statistics about Adequacy of leasing laws, regulations and directives

Statement	N	Minimum	Maximum	Mean	Std. Deviation
The current (807/2013) legal and regulatory framework is adequate to regulate the SME lease financing.	122	2.00	5.00	3.6639	.82932
The leasing laws and regulations have clarity in defining the lease contract, leased assets, responsibilities and rights of parties to a lease contract.	122	2.00	5.00	3.6639	.86827
The prudential regulation negatively affects the bank's involvement with SMEs regarding lease financing.	122	2.00	5.00	2.4115	.89380

The government growth and transformation plan positively affects the bank's SME lease financing.	122	2.00	5.00	3.6066	.89588
Directives from National Bank of Ethiopia regarding SME lease financing are adequate.	122	1.00	5.00	3.2705	1.00443
Due to change in lease financing policy applicants in process are pending.	122	2.00	5.00	4.1230	.68729
Overall, the legal and regulatory environment is favorable and supportive.	122	2.00	5.00	3.8770	.82900

Note: 1-Strongly disagree; 2-Disagree; 3-Neutral; 4-Agree; 5-Strongly agree
Source: Own Survey result, 2019

Respondents were asked for their level of agreement for the statement that states the current legal and regulatory framework is adequate to regulate the SME lease financing. Their responses were 50% disagreed, 27% agreed, 13.1% neutral and 9.8% strongly disagreed. This indicates that the current legal and regulatory framework is not adequate to regulate the SME lease financing.

For leasing laws and regulations clarity in defining the lease contract, leased assets, responsibilities and rights of parties to a lease contract, significant percent of respondents have disagreed with the percentage of 45.9% disagreed and 10.7% agreed while the remaining 27.9% neutral, and 15.6% strongly agreed. For the statement that says the prudential regulation negatively affects the bank's involvement with SMEs regarding lease financing significant respondents have disagree with mean value of 2.4 which indicates more than half of respondents have disagree. 51.6% disagree and 20.5% neutral while 16.4%, 11.5 agreed and strongly agreed respectively. Accordingly the implication of the responses of respondents is that the prudential regulation does not negatively affect the bank's involvement with SMEs regarding lease financing.

Significant percentages of respondents have agreed the statement that states the government growth and transformation plan positively affects the bank's SME lease financing. 34.4% and 37.7% of agreed and strongly agreed while the remaining 9.8% and 18% are disagreed and neutral respectively. The response of the respondents indicates the government transformation plan positively affects the bank's SME lease financing program. Respondents have also asked for their level of agreement regarding the directives from National Bank of Ethiopia. Accordingly, 40.4% of the answers as agree and 27.7% have strongly agreed. However, 32.8% and 32%

strongly disagreed and disagreed with statement that directive from National Bank of Ethiopia regarding SME lease financing is adequate. For the statement states that due to change in lease financing policy applicants in process are pending respondents have disagree with 59% disagreed while 29.7% strongly disagreed, 10.7% neutral and 2.5% agreed. This entails that the applicant in route are not pending because of the change in leasing policy.

Substantial percentage of respondents has agreed for over all favorability and supportiveness of the legal and regulatory environment. 52.2% of them have agreed and 21.3% are strongly agreed while the remaining 18.9% and 7.4% of them are neutral and disagreed, respectively. This further indicates that Overall, the legal and regulatory environment is favorable and supportive but not adequate have no clarity.

4.2.3.3 Awareness and Demand Level about Lease Financing

As lease financing is newly embarking banking financing solution in our country-Ethiopia, the level of awareness of stakeholders about its very purpose, contribution to economic development, future prospects and best practice is believed to highly determine the effectiveness and prospect of its services. Accordingly, questions that are associated to these variables were forwarded to the respondents to know their perception/opinion based on their level of understanding and to the best of their knowledge. The result is analyzed and presented in the table below.

Table 4.5.4 Descriptive statistics on the awareness and demand level of lease finance for SME

Statement	N	Minimum	Maximum	Mean	Std. Deviation
Customers have awareness about the major requirements of lease financing for Small and Medium enterprise	122	2.00	4.00	3.2295	.92519
The customers know about lease financing proclamations, directives, and operation process.	122	2.00	4.00	3.1475	.95927
The customers Knows that lease financing are offered to Small and Medium enterprise only by Development Bank of Ethiopia.	122	2.00	4.00	2.9426	.93860
The bank is providing lease financing products that meet the current demand of its customer.	122	2.00	4.00	3.2623	.80086

There is no demand for lease financing products other than the currently availed one.	122	2.00	4.00	3.3607	.83385
The bank has availed lease financing products that customers really need.	122	2.00	4.00	3.2377	.87247
Customers request more frequently lease financing for machinery and equipment purchase.	122	2.00	4.00	3.2295	.82107
Valid N (listwise)	122				

Note: 1-Strongly disagree; 2-Disagree; 3-Neutral; 4-Agree; 5-Strongly agree

Source: Survey result, 2019

When we look at the Customers awareness level about the major requirements of lease financing for small and medium enterprise, 33.6% respondents have disagreed 56.9% neutral while 9.8% agreed. Looking into the lease financing performance extended to SME by DBE, it showed poor performance that also arise from low level of customers awareness.

Similarly, asking the respondents about customer's awareness level of lease financing proclamations, directives, and operation process, 39.3% disagreed, 27.9% replied neutral while 32.8% agreed with the statement. In addition, asking the respondents about the customers awareness level that lease financing are offered to Small and Medium enterprise only by Development Bank of Ethiopia, 46.7% disagreed, 12.3% replied neutral while 41% agreed with the statement. 48.4%, 29.5%, 22.1% of respondents agreed, neutral and disagreed respectively with the statement that the bank is providing lease financing products that meet the current demand of its customer. In line with lease financing current demand, 52% respondents agreed with statement that the bank has availed lease financing products that customers really need while 28.7% disagreed. 59%, 23.0% and 18.0% respondents disagreed, agreed and answers neutral respectively with the statement that there is no demand for lease financing products other than the currently availed one. Regarding frequency of customers request for lease financing for machinery and equipment purchase, 47.5% agreed while 24.6% disagreed and 27.9% replied neutral.

4.2.3.4 Policies and Procedures to Finance SME Reduce that the Associated Cost.

This section aimed to identify whether the Bank's policy and procedure to finance SMEs reduces the associated cost. To get the respondent's levels of agreement six questions have been prepared regarding to this topic and responses of the participant have collected. The study tries to address issues like evaluation of the cost of the SMEs lease financing with other loans, adequacy of the banks policies and procedures to reduce these costs, reasonability of cost incurred regarding the SME lease financing specially administration and follow up costs. The study also tries to underline that whether there is budget for the costs and expenses are in accordance with budget and questions have addressed whether the overall the bank has proper policies and procedures to reduce cost associated with SME loans.

Table 4.5.5 Descriptive statistics about the bank's policies and procedures to finance SME reduces the associated cost.

Statement	N	Minimum	Maximum	Mean	Std. Deviation
Administration costs of SME Loans are higher than other loans.	122	2.00	4.00	3.1066	.87959
The bank's policies and procedures are well designed to reduce cost associated with SME Loans.	122	2.00	4.00	3.0492	.96939
Costs incurred for administration, follow up, and feasibility study of SME loans are reasonably determined by management.	122	1.00	4.00	3.0164	.98739
There is budget for costs of SME loans and costs are incurred as per the budget.	122	2.00	4.00	3.2459	.88431
The bank uses its maximum effort in reducing costs associated with SME loans.	122	1.00	4.00	3.0164	.92695
Over all the bank has proper policies and procedures to reduce cost associated with SME loans.	122	1.00	4.00	3.0738	.91062
Valid N (listwise)	122				

Note: 1-Strongly disagree; 2-Disagree; 3-Neutral; 4-Agree; 5-Strongly agree

Source: Own Survey result, 2019

For the statement that says administration costs of SME Loans are higher than other loans, percentage of respondents who agreed has significant portion with 44.3% agree and 33.6% disagreed while 22.1% responded neutral. This indicates that the administration costs of the SME loans are higher than other loans. According to interview result there is no different action taken by the bank to reduce the administration cost.

The respondents have asked the level of their agreement for the question stating that the Bank's policies and procedures are well designed to reduce cost associated with SME Loans. 41.5% of the have responded as disagreed and 27.9% of them have disagreed. The remaining respondents, 22.1% agreed and 8.5% responded neutral.

4.2.3.5 The Bank's Credit Risk Management Regarding SME Lease Financing

In this sub section the study was aimed to assess the bank's credit risk management while financing the small and medium enterprise. To get the appropriate data from the respondents fourteen proper questions have prepared and distributed. Accordingly the respondents have shown their level of agreement. The study prepares the questions by focusing of the credit risk management like comparison of SME loans with other loans that the bank provides regarding its risk and diversify ability, existence of separate unit to manage associated risk, management of credit limit, important information in selecting SMEs that minimizes credit risk of SME lease financing and management of credit exposure as well as indebtedness criteria.

Table 4.5.6 Descriptive statistics about the bank's credit risk management regarding SME lease financing

	N	Minimum	Maximum	Mean	Std. Deviation
SME Loans are riskier than are loans that the bank provides.	122	2.00	5.00	3.2295	.94289
SME loans risks are less diversifiable compared to other loans provided by the bank.	122	2.00	4.00	3.1148	.89255
The bank has separate unit to manage credit risks.	122	2.00	4.00	3.3033	.85173
The credit risk management of the bank is mostly done at the head office level.	122	2.00	4.00	3.4590	.77297
The credit risk management is done by credit analyst	122	2.00	4.00	3.2459	.85582
The bank has annual approval cycle for credit limits for overall SME portfolios.	122	2.00	5.00	3.3115	.90071
Credit analyst can override credit limits if considered necessary.	122	2.00	5.00	3.0820	.93234
Credit analyst must always adhere to credit limits and limits can only be changed by management.	122	2.00	5.00	3.2295	1.00237
In selecting SME, information on the owner is as important as information on the SME.	122	2.00	5.00	3.1393	1.00672
The credit analyst rely on qualitative assessment, (quality of SME management SWOT analysis the SME)	122	2.00	4.00	3.0492	.91681
The credit analyst relies on quantitative assessment. (Financial analysis of the SME)	122	2.00	4.00	3.1230	.90525
The bank manages credit exposure to SME using portfolio approach.(sector and geographic allocations)	122	2.00	4.00	3.3279	.77612

There are preventive indicators that are monitored to detect possible deterioration of credit outlook on SME loans	122	2.00	4.00	3.2541	.79836
The bank uses total debt outstanding to detect possible over indebtedness.	122	2.00	4.00	3.2705	.87232
Valid N (listwise)	122				

Note: 1-Strongly disagree; 2-Disagree; 3-Neutral; 4-Agree; 5-Strongly agree
Source: Own SPSS Survey result, 2019

The result of the survey shows that 41% of the respondents have agreed that the SME loans are riskier than other loans that the bank provides to its customers which indicate that the risk emanating from the SME lease financing loan is riskier than other loans while the remaining 29.5% disagreed, 23.8% neutral and 5.7% strongly agreed to the statement.

Significant portion of the respondents have also agreed to less diversify ability of the SME loans. 45.9% of the respondents have responded as agreed while the remaining 34% disagreed 19.7% neutral 10.6%. From this we can say that the SME loans risks are less diversifiable compared to other loans provided by the Bank. Therefore, riskier and less diversifiable loans needs special attention and follow up. Deep feasibility study and customer assessment required from the lender bank.

Respondents have also agreed with existence of separate unit that manages the credit risk of the bank. They have also shown their level of agreement which indicates that the credit risk management of the bank is at separate unit with 55.7% agreed while 25.4% disagreed and 18.9% neutral. Similarly they agreed with the statement that credit risk of the bank is mostly done at head office 63% agreed. The respondents were asked for their level of agreement that the bank has annual approval cycle for credit limits for overall SME portfolios. 50% of respondent agreed while 3.3% disagreed while 26.2% and 19.7% neutral.

The respondent also asked whether credit analyst can override credit limits if considered necessary or not. Their responses indicates that there is no approval cycle for the credit limits and once the limit is set by managements and credit analyst cannot override the limit.

Responses of the respondent further indicate that Credit analyst must always adhere to credit limits and limits can only be changed by management. 41.8 % of the respondents have disagree and 33.6 of them have strongly disagree for the statement about importance of SMEs and their owners in granting the SME lease financing loan to them. This further indicates that in selecting

SME, information on the owner is as important as information on the SME. The survey result also indicates that the credit analyst of the bank rely on both qualitative analysis like SWOT analysis of SMEs and quantitative analysis of financial statement of SMEs.

Respondents have asked for their level of agreement on the statement that says the bank manages credit exposure to SME lease financing using portfolio approach diversifying by sector and geographic allocation and responded as 51.8% disagreed while 29.5% disagreed, and 18.9% neutral. This implies that they do not mange credit exposure by the use of portfolio approach.

4.2.3.6 The Bank's Bad Loan Recovery Process Regarding SME Lease Financing

In this section the study tries to assess the bank's bad loan recovery process with regard to SME lease financing loans. Accordingly five proper questions have prepared and distributed to respondents mainly focusing on the existence effectiveness of bad loan recovery process.

Table 4.5.7 Descriptive statistics about the bank's bad loan recovery process

Statement	N	Minimum	Maximum	Mean	Std. Deviation
The bank has dedicated loan recovery unit	122	1.00	4.00	3.1066	.76932
There is specified date on which non serviced SME loans are considered overdue.	122	1.00	5.00	2.9672	.87135
The bank keeps tracks of costs incurred, time it takes and amount recovered in dealing with non-performing loans.	122	2.00	5.00	3.2623	.92534
The bank's bad loan recovery process is effective to recover bad loan and making it performing loan.	122	1.00	4.00	3.1803	.89088
Overall the bank has good bad loan recovery process.	122	2.00	4.00	3.1885	.93005
Valid N (listwise)	122				

Note: 1-Strongly disagree; 2-Disagree; 3-Neutral; 4-Agree; 5-Strongly agree

Source: Own SPSS Survey result, 2019

For questions regarding the bank has dedicated loan recovery unit positive answers with high level of agreement was responded. 42.2% of respondents have agreed while 24.6% disagreed and 35.2% replied neutral. The result of the survey also shows that there is specified date on which non-performing loans from SME lease financing are considered overdue.

4.3 Discussions and Interpretations

Based on interview and DBE's document review, specific sector focus of DBE's SME lease financing are, Agro-processing industries, Manufacturing industries, Tour industries, Construction industries and Mining and quarries that operates. However, according to the interview discussion, both lease financing and project financing credit analysis is served under the same roof at branch level.

Respondents have asked whether there are proper and approved suppliers of capital goods and give their responses. 58.2% strongly disagreed, 13.9% disagreed while 21% is neutral, 2.5% agreed and 4.1% strongly agreed. This shows that there is absence of proper suppliers of capital goods and challenges the bank to buy capital goods to the SMEs who have successfully processed and became worthy for the Lease financing program.

This would create problems like delay in supply, poor quality, and high cost of capital goods emanating from bargaining power of monopoly suppliers. Further this can be obstacles to both lessor and lessee because of the third party poor performance and awkwardness.
Respondents have also asked their level of agreement about challenges that the bank faces in financing SMEs through lease financing program and give their answers by agreeing almost all the challenges that are listed in the questionnaire. For macro- economic instability 62.3% agreed and 36.1% strongly agreed. For domestic regulation, 60% strongly agreed and 37% agreed. For poor quality of financial statement of SMEs 59% strongly agreed and 39.7% strongly agreed. For Lack of sufficient demand (absence of SMEs) or Available customers are not credit worthy, 63.9% strongly agreed and 32.3% strongly agreed. 65.6% strongly agreed and 36.6% strongly agreed was responded for lack of knowledge about SME lease financing. This result is an indication of the fact that those above listed (macro-economic instability, poor quality of financial statement of SMEs, Lack of sufficient demand (absence of SMEs, available customers are not credit worthy and lack of knowledge about SME lease financing) are challenges that the bank faces in involving with SME lease financing.

Results from interview also disclose almost similar findings to the above research question. The selection criteria for SME are not that much strictly followed and the one who comes as SME can get access if other formalities have fulfilled. Interviewed directors and managers have also list the government supports provided for SME lease financing program as Shelter and tax incentives for SMEs who have successfully process and became entitled for the SME loan. They have mentioned absence of adequate supplier as big challenges to the bank.

Additionally Interviewees stated the detail problem with SMEs capital Goods specification problem like ordering old models, unavailable or cannot be accessed easily, Low cost with poor quality that would be non-durable enough. This extends the period of loan processing back and forth rotation may be followed by default.

Macro-economic instability like inflation and interest rate fluctuation adversely affects the SME lending of the bank by creating inconvenient environment between the three parties the bank, the capital goods supplier and SMEs. Poor quality of financial statement of SMEs leads the bank to choose improper or to reject the one who was supposed to be qualified for the SME loan provided by the bank.

The bank cannot accomplish its SME Lease financing program without having sufficient targeted counterparties. Lack of sufficient demand hinders the bank to achieve its goal of disbursement and collection. The fund reserved for the SME lease financing remain non-performing incur opportunity cost. Lack of knowledge about SME lease financing by the government bodies as well as public at large was also big challenge to get necessary support from the government and loose public acceptance. This further leads to failure of the program afterwards the program cannot succeed without demand of the program and public acceptance.
The interviewees have asked for action taken by the bank to mitigate problem it faces in dealing with SME lease financing they have mentioned that the bank was trying to solve them. For instance there was awareness creation program but not effective and currently the bank decided to close and merge some branches that it opened to reach different regions of the country through the SME Lease financing.

According to DBE annual report 2017, Development Bank of Ethiopia (DBE) developed a policy and procedure Environmental and Social Risk Management that recognizes that effective management of environmental and social impacts associated with its operation is critical to the success of development projects including SMEs; The Bank will finance projects that are technically, economically and financially viable and meet adequate environmental and social standards. Therefore, the Bank will screen and classify all projects applied for financing according to their potential environmental and social impacts;

Looking into the extent of DBE involvement in SME lease financing, all units involve in the SMEs lease financing loan process such as all branch offices i.e., Grade A, B and C, branch and district office appraisal teams and branch and district office approval teams are responsible to ensure that all financed SMEs projects are environmentally friendly and within socially acceptable manner. These working units will undertake environmental and social assessment of projects as per the requirement checklist, lease financing policy for SMEs and procedure manual for lease financing.

Additionally researcher have reviewed the document of the bank stating that government priority areas are identified as manufacturing sector specially those who export 80% their product can get incentives like reduction of interest rate. This indicates that the bank have sector wise focus and priority of the government development program should be followed in balancing sectors to be financed through SME lease financing program.

Regarding the awareness and demand level of customers for lease financing, this study show low level of awareness but those aware about the product are actively applying for their lease finance needs.

From the banks policies and procedure with regard to reducing costs associated with SME loans it is not well designed. Even if there was demand for good and well-designed internal policies and procedures that reduces costs of SME loans, the bank fail to do so. This charge the bank to incur costs that it was not supposed to pay for and decrease its profitability as well as success in the program.

More than half of Respondents have disagreed that the costs incurred for administration, follow up, and feasibility study of SME loans are reasonably determined by management. They have revealed that even if there was procedure it was not clearly defined and subject to misuse meaning not helping to reduce costs.

Results from the interview also lead to the similar implication with the questionnaire.

Interviewees have identified SME loans as high riskier and less diversifiable but it was treat the same as other loans even if needs special needs attention. Since the collateral of the SME lease financing loan is project of the SMEs itself, project presented by the SMEs should be deeply studied and all necessary observation was supposed to be done prior to granting loan.

Furthermore the result of the survey realizes that the bank keeps track of costs incurred, time it takes and amount recovered from non-performing loans. Similarly respondents have disagreed to the statement says that the bank's loan recovery process is effective and good enough to recover the loan and make it performing loan. 50% of respondent disagreed, 32.0% neutral and 18% agreed. Over all implication of the respondents' level of agreement shows that the bank has no proper bad loan recover process. 54.1% of respondents disagreed with the statement. Interviewees have stated that the bad loan recovery unit of the bank does not make its maximum effort to make it performing loan and it cannot be said as adequate.

Moreover, it can be understood from the explanation they give about the process to rehabilitate suspended loan that the bank has dedicated loan recovery unit. They provide different supports like additional fund, technical supports and tax holiday based on its potential of recovery. According to both questionnaire and interview over all there is significant problem regarding loan recovery process of the Bank.

CHAPTER FIVE

5. SUMMARY OF MAJOR FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

5.1 Chapter Overview

This final chapter presents the summary of major findings, conclusions, recommendations and limitation based on findings and analysis of the study. The study attempted to look into the banks involvement in SME Lease financing, extent of adequacy of legal and regulatory framework of SME lease financing, awareness and demand level of lease financing, the bank's policy and procedure in reducing costs associated with SME Lease financing, the bank's bad loan recovery and credit risk management process. Moreover, the study has also tried to collect views and opinions of the SME lease financing staffs, team managers and directors who deal with SMEs on the level of lease financing awareness and challenges of the sector which have been analyzed subsequently. Thus, on the basis of analysis of the data, the following summary of major findings, conclusions and recommendations are forwarded.

5.2 Summary of Major Findings

In this section, the major findings of the study have been discussed in view of the imperial literatures that have been reviewed in Chapter two. Categorizing in to six specific objectives the study has identified challenges that the bank face in financing SMEs through SME Lease Financing Program as follows.

The study have identified the banks SME selection criteria, lack of proper suppliers of capital goods, sector wise focus of the bank in financing SMEs, macro-economic instability, low level of customers awareness, poor quality of financial statements of SMEs, lack of sufficient demand and lack of knowledge about SME lease financing as challenges. Except lack of sufficient demand and macro-economic instability, all of the above challenges were supported by literatures. Findings from empirical evidences support the selection criteria as challenge for banks. For instance Abdulaziz and Andrew, 2016 found that the selection criteria that basis relationship with bank rather than worth of the SMEs as well as sector focus financing as challenge. Findings from works of scholars like Alyosius and Lubinda as well as Asfaw Abera reveal lack of proper supply chain like lack of proper suppliers of capital goods as challenges. Chowdhury et al., 2013 have identified lack of knowledge about SME lease financing as one of challenges in their study.

The study conducted by Okoth, M. O. 2015 also reveal poor or absence of financial statements of SMEs as challenge for banks and other financial institutions to finance them. In addition to the above challenges the study have also highlighted obstacles of the SME Lease financing program as lack of controlling costs associated with SME lease financing program and poor credit risk management of the bank. Regarding the adequacy of SME lease financing laws, regulations and directives affecting the bank the result of the study indicates that it lacks clarity and not comprehensives. The respondents have responded regarding the laws and regulations as well as directives that it is not adequate and supportive in prevailing Small and Medium Enterprise lease financing of DBE particularly in case of default, weak coordination among stakeholders.

In Ethiopia, SME classification also makes confusion for customers and among the stakeholders. In accordance with the Government Micro and Small Enterprise Development Strategy, "Small Enterprise" under the industry sector is defined as an enterprise operates with between 6 and 30 employees including the owner and its family; and its total assets worth between Birr 100,001 and Birr 1.5 million excluding the value of land and building; "Medium Enterprise" under the industry sector is defined as an enterprise operates with above 31 employees and its total assets worth above Birr 1.5 million excluding the value of land and building. But in the context of DBE, Small and Medium Enterprises shall mean an enterprise in the Agro-processing industries, Manufacturing industries, Tour industries, Construction industries and Mining and quarries that operates with above 6 employees and has total capital from Birr 500,000 to Birr 7.5 million.

A number of challenges like: lack of appropriate management information systems (MIS), lack of funding, lack of prior leasing awareness by the players in the leasing eco-system that includes the potential lessor, lessee, and the supplier, absence of good integration of stakeholders, lack of leasing expertise in the market; existence of inadequate supply chain linkages as well as procurement hurdles; existence of limited domestic suppliers; and absence of specialized leasing training center, non-court repossession or easy contract enforcement mechanisms in case the lessee defaults; absence of adequate lease equipment/machinery manufacturing, Shortage of hard currencies are the main challenges currently exist in the lease sector raised by the interviewees.

As the interview results from key respondents indicates basically lack of stakeholder integration, shortage of hard currencies and re-possession are freighting burden for the lease companies. Especially for imported machinery lease processing time is long due to the delay to get letter of credit or dollar problem, sometimes in appropriate selection of machinery by the lease and supplier problem. These conditions more or less creates discomfort to the lessee and even change the attitude of others since the one who is in the system does not provide information that initiate others to enter the lease business. So, if the existed customer is not satisfied and encouraged how the other would have interest to come. Thus formations of such kinds of information could be taken as an obstacle for the lease development.

In contrary to its challenge, SME lease financing has a positive outlook according to the interviewees. Leasing sector is recently experiencing positive development. There is a growing interest by the government, as well as by private sector players, to integrate leasing as a crucial instrument to address the gap in access to finance and meet economic growth targets. Growing number of inquiries are coming to NBE from both domestic and foreign investors pertaining to establishing a leasing company as a report of leasing regulatory analysis at prime project indicates. And also the positive economic growth of the country and the policy of industry focus bring a future bright of the lease sector.

In the II-GTP program, the governments of Ethiopia key priority industries need capital equipment‘s or machineries and have its own potential to enhance the leasing market. Currently, leasing companies are expected to provide lease finance for machineries and equipment to the priority areas such as:

(a) Textile, garment, leather and leather products; (b) metal and wood works ;(c) agro-processing, including dairy and poultry equipment; (d); construction machineries;(e) irrigation;(e) wet and dry coffee processing; (f) post-harvest grain processing including seed cleaning equipment; and (g) freight transporters from fields to market centers and warehouses, (h) farm and non-farm cooperatives, unions, and model farmers.

As the interview results indicates the product of the lessee have high market or there is high demand of products or service provided by the lessee. This gives a positive futurity to the lease system. Generally, lease financing has imperative future since it has significant contribution for the national economy. As it strongly enhances the development of SME which in-turn stimulates the economic growth as well as creates additional job opportunities it gets focus by the government. In addition, it is a way for new investment opportunities and invitees private and foreign investors on it. And also it fosters the development of agribusiness and value chain system if sound participation exists in the agro-processing and agricultural industry. All these and other priority area focus makes lease financing attractive to the future.

5.3 Conclusions

In Ethiopia, SME lease financing is at its infant stage of development. It is implemented only by one government development bank i.e. Development Bank of Ethiopia. Although the SME lease financing sector has potential prospects for growth, it has encountering challenges at its inception stage. The following conclusions have been drawn on the basis of the analysis of the study.

Result of respondents for the section about lease financing legal and administrative frameworks with regarding to SME Lease financing pave ways to conclude that the bank have SMEs among its client and the bank selects those SMEs based their total asset then capital. The bank has separate unit that manages the banking relation with SMEs. From the side of Government, the Ethiopian government prepares adequate shelter and tax incentives for these SMEs who have approved by the bank to be user of the SME lease financing program as one of growth and transformation plan II (GTP II) Furthermore, according to the result of the study challenges that the bank faces have been identified but not limited to the following:

- **Absence of proper and sufficient suppliers of capital good**s which leads to poor supply chain system. The bank does not engage in direct purchase of capital goods to be provided for SMEs by lease. So it is through suppliers of capital goods and if there is no proper and sufficient suppliers, this may be wicked for the bank as well as for the users SMEs.
- **Macro-economic instability like inflation and currency fluctuation: This can be the challenge** to the bank by inflating the cost of the capital goods that their client SMEs cannot afford according to their previous specification and creates dissatisfaction among them. Similarly it makes several SMEs to be less credit worthy
- **Poor quality of Financial statement of SMEs**. Since the bank relies on both qualitative

and quantitative analysis of the SMEs, poor financial statement which have no characteristics accounting information system like relevancy and reliability creates difficulty in making sound decision whether to select or not as its client to use the SME lease financing program.

- **Lack of Sufficient demand (absence of SMEs) or available SMEs are not credit worthy**. As it can be observed from the secondary data published by the bank, the bank have launch the program by expecting sufficient demand from the country and open different branches all over the parts of the country by incurring high cost but not getting SMEs as expected. According to the interviewees currently the bank is merging and closing its distributed branch by the aim of reaching the SMEs all over the country.

- **Lack of knowledge about SME lease financing**. The bank is facing challenges from absence knowledge about SME lease financing that hinders it from performing well as it plans.

- **Poor management of credit risk by the bank.** According to the result of the survey the bank is facing difficulty because of poor management of credit risk simply by using total debt outstanding to detect possible over indebtedness. Information on the owners is not valued as that of the respective SMEs which dangerous for the loan provided to the SME. There is no separate unit to manage those risks that emanates from SME loans that was supposed to be reduced to the minimum possible level.

- **Lack of the Bank's proper policy and procedure to reduce costs associated with SME lease financing.** The study has also found that the bank has no proper policy and procedure that minimizes the cost associated with SME lease financing loans to the minimum possible. In principles both costs that are added to the loan and that are expensed by the bank should be kept minimum so that it is convenient to both parties. But the bank has loosely organized policies and procedures to finance SMEs that does not reduce the associated cost.

- **The study implies that the current legal and regulatory framework is not adequate**, lacks clarity, as hire purchase permit partial ownership it is difficult during foreclosure.

- **The bank's bad loan recovery process is also a challenge for DBE**. Even though the bank has dedicated loan recovery unit that identify non serviced SME loans, keep track of costs incurred and effectively recover bad loan, because of lack of directive clarity and stakeholders interference in it is a challenge for loan recovery.

5.4 Recommendations

Finally based on the research finding and analysis done, the study forwarded the following recommendations.

- **Specific legal and administrative framework is very required** for some of key issues for the further development of SME lease financing, which requires police measurement to create a better business environment and laws to providing regulations on registration of lease asset, on selection criteria, establishment of a supervisory authority, tax treatment, and collaboration among stack holder ,Therefore ,all the stack holder should revise the legal and administrative framework for SME lease financing and DBE should not rely only on the asset of the SMEs as selection criteria. Rather it should use asset and capital as well as purpose of formation as selection criteria to grant SME loan and have development the strong internal policies and procedures that can keep the costs associated with SME lease financing loan to minimum possible. This can help the bank to get survival profit to serve its goal. Similarly, the bank should also have good credit management unit that have flexible preventive indicators to detect possible deterioration of SME loans.
- **In addition, extensive training should be arranged for SME** companies to promote and engage them in development agenda of GTP II. Regarding lack of sufficient demand, the bank should highly work on the promotion about their new product which is SME lease financing and explain their clear and precise requirements from SMEs to give the SME lease financing loan. In addition to this, the bank should also have experienced and dynamic credit analyst that has flexibility in reducing risk of SME loans. On the other hand, financing all sectors is recommended to get sufficient demand and diversify its SME loans.
- **SMEs should highly fulfill all necessary requirements and comply with laws, regulations and directives of SME lease financing issued by different governing bodies of the country** .Since the nature of SME lease financing loan is different from

other loans and riskier than other loans,. Once they have satisfied these necessities it is easy for the bank to provide the requested service which in turn helps both parties achieving their goal. They should have also prepared reliable and relevant financial statement that can fully show their required financial requirement.

- **Government of Ethiopia should play its vital role in spite of giving direction to the bank.** According to the document reviewed about necessity and formation of SME lease financing program as well as the overall goal of the bank, it is concluded that it is government development program launched through Development Bank of Ethiopia. Therefore it is highly recommended that the government of Ethiopia should play its vital role in spite of giving direction to the bank because it is difficult for the bank to take action end to end its alone rather it needs cooperation to make the SME lease financing program fruitful. Since government have ultimate power most of the challenges assessed and identified by the study are recommended as they demand efforts government. Accordingly the study has strongly suggests that it is very decisive if the following issues have catch eyes government.
- **Lease financing should be well advertised to SME and citizens of the country to create better Awareness.** As long as SME lease financing is new phenomenon in the country, it needs deep and continuous awareness creation program for respective citizens of the country especially for existing and potential SMEs to bridge knowledge gap and make the SME lease financing fruitful. The beliefs as solution for problems emanating from lack of knowledge and lack of demand occurs due to drought of alertness about SME lease financing.
- **Facilitating for suppliers of capital goods.** There should be legally registered and responsive suppliers of capital goods that can smooth the awkward supply chain that discourage the development and progress of SME lease financing.

- **Motivate and closely follow up SMEs to maintain proper book of account; SMEs** should practice to prepare sound financial statement that can represent their business organization. This can help the bank who provide SME lease financing loan to analysis their financial statement and make decision.

5.5 Contributions of the Study

The findings of the this study have significant contributions that can be categorized under contribution to the body of knowledge, contribution to the practitioners and stakeholders, as well as the contribution to the policy makers and regulators. This research serves to offer valuable contributions to existing literature. First, this study has contributed to theoretically better understand the dynamics of SME lease financing by financing mediator of Ethiopian context.

5.6 Limitation and Future Area of the Study

This study was conducted to find the challenges and prospects of lease financing for SME. This study has focused on employees of DBE in Addis Ababa regions. Hence, it has also uncovered many areas that need additional study. The purpose of this section is therefore to identify and discuss the need for further research in similar topic. Therefore, future studies should be carried out on sample of all stakeholders to reflect their challenges with the lease financing.

Finally, the other limitation of this study is that, since the study only focused on employee of DBE, it will be subject to some biased. In Addition the study have used qualitative research design due to absence of secondary financial data. This is because the bank has no trend data as it starts the SME lease financing in the past 3 years. Therefore replicating the study using quantitative financial data trend can also reflect more useful findings.

Reference

Asfaw A., 2016. Lease Financing In Ethiopia: Assessment of Five Regulated Lease Financing Companies, Addis Ababa.

Ashenafi B.,2012. Banking Reform and SME Financing In Ethiopia: Evidence From The Manufacturing Sector. African Journal of Business, 6(19). doi:10.5897/ajbm120516

Ayyagari, M., Beck, T., and Kunt, D. 2007. "Small and Medium Enterprises across the Globe: A New Database." Small Business Economics 29 (4): 415–34.

African Development Bank .,2011, Federal Democratic Republic of Ethiopia: Country Strategy. Paper, April 2011.

Alyosius, C., and Lubinda, H. 2013. A Study Of The Development Of Leasing Industry In Zambia. International Journal of Sciences: Basic and Applied Research

Asimakopoulos, I., Samitas, A. and Papadogonas, T. 2009. Firm Specific and Economy Wide Determinants of Firm Profitability: Greek Evidence Using Panel Data. Managerial Finance, 35 (11), 930-939.

Berger, A. and Udell, G. 2005. A More Complete Conceptual Framework for Financing of Small and Medium Enterprises:World Bank Policy Research Working Paper No. 3795. December 2005.

Berhanu B., 2017, Lease financing scheme to reach 3000 SMEs with USD 276 million: The reporter news paper. https://www.thereporterethiopia.com/article/lease-financing-scheme-reach-3000-smes-usd-276-million. Access on February 22,2019

Bierman, H. 2005, The Lease versus Buy Decision: Englewood Cliffs, NJ: Prentice-Hall.

BIS, 2012. SME access to external finance: BIS Economic Paper No. 16. January 2012.

Burgress, D.O. 2002, Buy or lease: the eternal question, Journal of Accountancy, 187(4), 25- 33.

CGAP and IFC.2013. Financial Access 2012: Getting to a More Comprehensive Picture. Washington, DC.

Creswell, J.,2003.Research Design. Qualitative, Quantitative and Mixed approaches. 2nd ed.,New Delhi: Sage.

Creswell, J.2009. Business research methods: qualitative, quantitative, and mixed methods approaches, 2nd edition, Sage publisher, California.

Federal Democratic Republic of Ethiopia (FDRE) 2012., Investment Areas and Incentives Regulation No. 270/2012: Addis Ababa, Federal Negarit Gazette. November 2012.

Federal Democratic Republic of Ethiopia (FDRE) 1998, 'Capital Goods Leasing Business' Proclamation No. 103/1998 :(Addis Ababa, Federal Negarit gazette 4th year No. 27 March, 1998).

Federal Democratic Republic of Ethiopia (FDRE) 2013, 'Capital Goods Leasing Business' Proclamation No. 807/2013: (Addis Ababa, Federal Negarit gazette 9th year No. 60 July, 2013).

GPFI and IFC.2011. SME Finance Policy Guide. Washington, DC.

GTP II 2016, Growth and Transformation Plan II (GTP II) from (2015/16-2019/20): Volume I: Main Text. National Planning Commission May, 2016 Addis Ababa

Gallardo, J. 1997. Leasing to support small businesses and microenterprises: The World Bank. Policy Research Working Paper 1857. December 1997.

Idowu, F.C,2010, Impact of Microfinance on Small and Medium-Sized Enterprises in Nigeria: Konjit Setotaw 2019. Mereja.com 2019. https://mereja.com/amharic/v2/author/konjit

Kraemer-Eis H. and Lang F. 2012, The importance of leasing for SME finance: Working Paper 2012/15.

Mohammad, S. A and Shamsi, B. 2008. Determinants of financial leasing development in Jordan: Studies in Business and Economic Journal, Qatar University, 14, (2).

Nair,A., Todd,R., Mulder, A. 2004. Leasing: An Underutilized Tool in Rural Finance, Agriculture and rural development: The International Bank for Reconstruction and Development, The World Bank

National bank of Ethiopia (NBE) 2013, Licensing of Capital Goods Finance Service: Directive number 102/2013 . Addis Ababa.

National bank of Ethiopia (NBE) 2013: Licensing and Supervision of Capital Goods Finance Companies: directive number 02/2013 Addis Ababa.

National bank of Ethiopia (NBE), 2017: Minimum paid up capital requirements: Directives N0. CGFB/07/2017,.

National bank of Ethiopia (NBE) ,2019, Limit on Capital goods finance exposure to a single lessee: Directives N0. CGFB/09/2019 Addis Ababa.

National bank of Ethiopia (NBE), 2016: Manner of financial and operational information reporting: Directives N0. CGFB/03/2016, Addis Ababa.

National bank of Ethiopia (NBE) ,2016: Capital adequacy ratio requirement: Directives N0. CGFB/04/2016, Addis Ababa.

National bank of Ethiopia (NBE) 2017: Penalty for failure to comply with regulatory requirements, and licensing requirements: Directives N0. CGFB/06/2017, Addis Ababa.

Osaze, E. B. 1993,. Leasing Financing in Nigeria: Lagos. Pacific Printers Nig. Ltd.

Salam, A.,2013,. Effects of Lease Finance on Performance of SMEs in Bangladesh: International Journal of Science and Research (IJSR), ISSN (online): 2319 7064, 2 issue 12, December 2013.

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

UNCTAD, 2019.Improving the Competitiveness of SMEs in developing countries; the Role of Finance to enhance Enterprise Development, 2002. [Online] Available: [Accessed 3 march 2019] http://www.unctad.org/en/docs/itetebmisc3_en.pdf

Wolday A. William M., Fasika J. 2016, Opening Doors: A Performance Evaluation of the Development Credit Authority (DCA) in Ethiopia. USAID/Ethiopia. May 2016, Addis Ababa

World Bank 2015.SME Finance in Ethiopia: Addressing the Missing Middle Challenge: Washington, DC.

Yamane, T. 1967, Elementary Sampling Theory: Prentice-Hall, Inc., Englewood Cliffs

Yonas A. 2018, DBE approves over 5.7 bln birr lease finance to SMEs: The reporter news paper. https://www.thereporterethiopia.com/article/dbe-approves-over-57-bln-birr-lease-finance-smes. Accessed on January 28, 2019

Appendix 1: RESEARCH INSTRUMENT: QUESTIONNAIRES

ADDIS ABABA UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING & FINANCE

MSC PROGRAM

Dear Sir/Madam,

I am conducting research on "Challenges and Prospects of Lease Financing in Ethiopia with Particular Evidence from Development Bank of Ethiopia's Small And Medium Enterprises" for partial fulfillment of MSC in accounting and finance at the College of business and economics, Addis Ababa University.

Hence, I hereby kindly request your participation in completing the questionnaire. As the purpose is purely academic, I assure you that all information you will provide will be kept strictly confidential and shall be used for only this purpose.

Finally, I thank you very much in advance for your cooperation and for sacrificing your invaluable time to fill the questionnaire.

For any Information and unclear situation please contact me by the below mentioned address

Mobile: +251913 71 36 23

Email: mararsa2@gmail.com

Yours Sincerely, Mengistu Ararsa

Section I: Respondent Profile

Please kindly put "X" mark or respond in writing as appropriate.

1. Gender

Male ☐ Female ☐

2. Age

Less than 25 ☐ 26 – 35 ☐ 36 – 45 ☐ 46 – 55 ☐ Above 56 ☐

3. Educational Qualification

Master's Degree and above ☐ First Degree ☐ Diploma ☐

Technical/Vocational Certificate ☐ Other (please specify) ____________________

4. Working Experience

Less than 5 years ☐ 6 – 10 years ☐ 11 – 15 years ☐

16 – 20 years ☐ over 20 years ☐

5. Current position in your organization ____

In the following sections, the researcher is seeking your specific perceptions towards each question under seven sub-topics as mentioned below. Please kindly indicate (X) mark to express the extent to which you agree or disagree on the given statement from the choices:

1= SD = Strongly Disagree; 2= D = Disagree; 3= N = Neutral; 4= A = Agree; 5= SA = Strongly Agree

Section II: Lease Financing Legal and Administrative Frameworks with SME Lease financing

No.	Statements	SD (1)	D (2)	N (3)	A (4)	SA (5)
1	The bank's selection criterion for SME is the client's total asset over capital.					
2	The bank has sufficient long term fund to support its SME Lease financing program.					
3	The bank has a separate unit managing the banking relation with SMEs.					
4	There is Tax incentive by tax authority for SMEs who are users of the SME lease financing program.					
5	There is adequate shelter prepared by government for SMEs who are user of SME Lease financing.					
6	There are sufficient and proper suppliers of capital goods to buy for approved SME lease financing applicants.					
7	The bank have a sector-specific focus in dealing with SMEs					
8	The bank have a specific geographic focus in dealing with SMEs					
9	The following factors are obstacles to the bank' s involvement with SME regarding SME Lease financing: • Macro-economic instability.(like inflation, currency fluctuation)					
	• Domestic regulations					
	• Poor quality of Financial statement of SMEs					
	• Lack of sufficient demand (absence of SMEs) or Available customers are not credit worthy.					
	• Lack of knowledge about SME lease financing.					

Section III: Extent of adequacy of leasing laws, regulations and directives affecting the SME leasing business in Development Bank of Ethiopia.

No.	Statement	SD (1)	D (2)	N (3)	A (4)	SA (5)
10	The current (807/2013) legal and regulatory framework is adequate to regulate the SME lease financing.					
11	The leasing laws and regulations have clarity in defining the lease contract, leased assets, responsibilities and rights of parties to a lease contract.					
12	The prudential regulation negatively affects the bank's involvement with SMEs regarding lease financing.					
13	The government growth and transformation plan positively affects the bank's SME lease financing.					
14	Directives from National Bank of Ethiopia regarding SME lease financing are adequate.					
15	Due to change in lease financing policy applicants in process are pending.					
16	Overall, the legal and regulatory environment is favorable and supportive.					

Section IV: Customer's Awareness Lease financing and their demand level Lease financing

No.	Statement	SD (1)	D (2)	N (3)	A (4)	SA (5)
17	Customers have awareness about the major requirements of lease financing for Small and Medium enterprise					
18	The customers know about lease financing proclamations, directives, and operation process.					
19	The customers Knows that lease financing are offered to Small and Medium enterprise only by Development Bank of Ethiopia.					
20	The bank is providing lease financing products that meet the current demand of its customer.					
21	There is no demand for lease financing products other than the currently availed one.					
22	The bank has availed lease financing products that customers really need.					

23	Customers request more frequently lease financing for machinery and equipment purchase.					

Section V: identifying whether the bank's policies and procedures to finance small and medium enterprises reduces the associated cost**.**

No.	**Statement**	**SD (1)**	**D (2)**	**N (3)**	**A (4)**	**SA (5)**
24	Administration costs of SME Loans are higher than other loans.					
25	The bank's policies and procedures are well designed to reduce cost associated with SME Loans.					
26	Costs incurred for administration, follow up, and feasibility study of SME loans are reasonably determined by management.					
27	There is budget for costs of SME loans and costs are incurred as per the budget.					
28	The bank uses its maximum effort in reducing costs associated with SME loans.					
29	Over all the bank has proper policies and procedures to reduce cost associated with SME loans.					

Section VI: Assessing the bank's credit risk management regarding SME lease financing

No.	**Statement**	**SD (1)**	**D (2)**	**N (3)**	**A (4)**	**SA (5)**
30	SME Loans are riskier than are loans that the bank provides.					
31	SME loans risks are less diversifiable compared to other loans provided by the bank.					
32	The bank has separate unit to manage credit risks.					
33	The credit risk management of the bank is mostly done at the head office level.					
34	The credit risk management is done by credit analyst					
35	The bank has annual approval cycle for credit limits for overall SME portfolios.					
36	Credit analyst can override credit limits if considered necessary.					
37	Credit analyst must always adhere to credit limits and limits can only be changed by management.					
38	In selecting SME, information on the owner is as important as information on the SME.					

39	The credit analyst rely on qualitative assessment, (quality of SME management SWOT analysis the SME)					
40	The credit analyst relies on quantitative assessment. (Financial analysis of the SME)					
41	The bank manages credit exposure to SME using portfolio approach.(sector and geographic allocations)					
42	There are preventive indicators that are monitored to detect possible deterioration of credit outlook on SME loans					
43	The bank uses total debt outstanding to detect possible over indebtedness.					

Section VII: Analyzing the bank's bad loan recovery process regarding Small and medium enterprise.

No.	**Statement**	**SD (1)**	**D (2)**	**N (3)**	**A (4)**	**SA (5)**
44	The bank has dedicated loan recovery unit					
45	There is specified date on which non serviced SME loans are considered overdue.					
46	The bank keeps tracks of costs incurred, time it takes and amount recovered in dealing with non-performing loans.					
47	The bank's bad loan recovery process is effective to recover bad loan and making it performing loan.					
48	Overall the bank has good bad loan recovery process.					

Appendix 2: RESEARCH INSTRUMENT: Interview Question

Dear Sir/Madam,

The main objective of this interview is to explore information regarding Challenges and prospects of Lease financing in Ethiopia: Evidence from DBEs' Small and Medium Enterprise. In addition to the questionnaires distributed to staffs of Development Bank of Ethiopia Small and Medium Enterprise Lease Financing Directorate, in-depth response to the research problem is also is very important. The interview will be made with selected directors and team managers of the same directorate who are familiar with the issue. The information you provide in response to the questions in the interview will be used as part of the data needed for a study.

I would like to assure you that the information you provide will be accessible only to the academic purpose. Your involvement is regarded as a great input to the quality of the research results. Thus, I believe that you will enlarge your contribution by participating in the study.

Thank you very much for your valuable time and thoughtful response.

Best regards,

Mengistu Ararsa

Interview Question for Directors and Team Managers of Development bank of Ethiopia Small and Medium Enterprise Lease Financing Directorate:

1. Are the current leasing laws and regulations having clarity and adequacy to regulate the SME lease financing sector?
2. Do you think the legal and regulatory environment regarding SME lease financing is favorable and supportive?
3. What are policies and procedures that your bank uses to reduce administration costs associated with SME loans?
4. Do you think they are adequate enough to help the bank incur reasonable costs?
5. Among your bank's loan portfolios which one is riskier and less diversifiable?
6. How your bank does manage credit risk regarding SME loans?
7. What are your bank's bad loan recovery process regarding SME lease financing?
8. Are they adequate enough to recover bad loan and make it performing loan?
9. What efforts does your bank make to recover bad loan?
10. Over all what is the current status and future potential of SME Lease Financing in your bank to achieve the banks as well as the government development plan?
11. What are the prospects of SME lease financing in Ethiopia?