



**ADDIS ABABA UNIVERSITY
DEPARTMENT OF ACCOUNTING AND FINANCE
SCHOOL OF GRADUATE STUDIES**

**LEASE FINANCING IN ETHIOPIA: AN
ASSESSMENT OF FIVE REGULATED
LEASE FINANCING COMPANIES**

By

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Declaration

I hereby declare that this thesis is my original work has not been presented for a degree in any other university and that all sources of material used for the thesis have been duly acknowledged.

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Acknowledgement

First and foremost, I would like to thank and praise the Almighty God for being my savior and source of strength to successfully complete this study.

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Important Quotes:

The essence of leasing is the separation of property from ownership (Bruce, 1988).

Leasing is based on the proposition that income is earned through the use of assets, rather than from their ownership (World Bank, 2000).

Abstract

The focus of this research is to assess the current state of lease financing in Ethiopia and investigate the challenges or impediments of the sector as well as its review of legal and regulatory framework. Leasing is an alternative to traditional forms of financing particularly for SMEs, although it's yet underdeveloped in Ethiopia and currently at its infant stage. The research approach adopted in this study was a mix of quantitative and qualitative method. Both primary and secondary data were used as evidence for the study. In identifying the respondents from the study population a mix of both random and purposive sampling were adopted. All the five regulated lease finance companies as well as supervisory bodies were included in the sample. The study found out that 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 in the country. Despite these challenges, the study identified that leasing has high market potential for growth in Ethiopia due to government's attention to support the manufacturing sector and SMEs financing through equipment leasing. This is evidenced by both the survey analysis and interview result. The conclusions are based on 42 leasing stakeholders' questionnaire – response and the outcome of the in-depth interviews of the executives of leasing companies, officials of MOT and EIC as well as selected leasing experts. The study recommends changes to legal and regulatory framework to create an enabling environment for leasing development and ensure clarity of leasing laws and regulations as well as challenges of the leasing sector be resolved by the concerted efforts of key stakeholders in a way that spur the development of leasing in the country.

Keywords: Leasing, lease finance, equipment leasing, capital goods finance.

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ACRONYMS

AEMFI	Association of Ethiopian Microfinance Institutions
CEO	Chief Executive Officer
CGAP	Consultative Group to Assist the Poor
CGFCs	Capital Goods Finance Companies
CSA	Central Statistic Authority
EIC	Ethiopian Investment Commission
ELFA	Equipment Leasing and Finance Association (US)
ERCA	Ethiopian Revenue and Customs Authority
FeMSEDA	Federal Micro and Small Enterprises Development Agency
FASB	Financial Accounting Standard Board
GDP	Gross Domestic Product
GPFI	Global Partnership for Financial Inclusion
GTP	Growth and Transformation Plan
IAS	International Accounting Standards
IASB	International Accounting Standard Board
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
ILO	International Labor Organization
IMF	International Monetary Fund
LDC	Least Developed Countries
MFI(s)	Microfinance Institution(s)
MOT	Ministry of Trade
NBE	National Bank of Ethiopia
OECD	Organization for Economic Cooperation and Development
SME(s)	Small and Medium Enterprise(s)
US	United States
USD	United States Dollar
VAT	Value Added Tax
WB	World Bank
WLYB	World Leasing Year Book

CHAPTER-ONE

1. INTRODUCTION

1.1. Background of the study

Globally, financial access is one of the most widely discussed topic in business (World Bank, 2004 & 2006; CGAP, 2013; IMF, 2013; Nair, 2004; and IFC, 2009). Lack of access to finance is the biggest obstacle affecting SMEs, micro enterprises and new firms in developing countries (IFC, 2009). Though it is believed that SMEs play a key role in economic development and make an important contribution to employment and GDP (Ayyagari, Beck and Kunt, 2007), access to finance remains a key constraint to SME development, especially in emerging economies. 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). Yet, many governments have recognized the SME sector as an important driver of economic development and employment creation, and also see as a priority (MIDAS, 2009 in CGAP & IFC, 2013).

Moreover, according to CGAP and IFC (2013), access to finance for managing cash flows, funding investments, and insuring against risk is one important barrier for SMEs' growth, alongside non-financial barriers such as infrastructure. Nevertheless, higher income countries tend to have more developed SME finance markets than that of developing countries as measured by ratios of SME finance volume-to-GDP and SME loan accounts-to-total firm loans. In low-income countries, only a small percentage of enterprise loan accounts are held by SMEs.

Similarly, in Ethiopia, as in many developing economies, SMEs have very limited access to bank credit or other financial services. According to a survey conducted by IMF (2013), in 2012/13, 79 percent of total loans issued by the banking sector were allocated to the big public enterprises, with only 21 percent going to the private sector (mainly comprises SMEs). This is due to the fact that SMEs possess insufficient collateral or credit history to access more traditional bank finance. Evidence from the recent study of SME finance in Ethiopia by the World Bank

(2015) reveals that only 3% of small enterprises and 23% of medium have a loan facility or a line of credit mainly due to extreme high value of collateral needed for a loan, corresponding to 249.3% and 253.5% of the loan for small and medium enterprises, respectively against a Sub-Sahara African (SSA) average of 160%.

Although finance is not everything, enterprises need finance to invest in new equipment and machinery, reach out to new markets and products, cope with temporary cash flow shortages as well as to innovate and expand (Fafchamps, 1997 as cited by Gebrehiwot & Wolday, 2006). Moreover, a survey of the Central Statistical Agency (2010) indicates that lack of adequate capital is the first major problem of small-scale manufacturing establishments starting operation. A similar study carried out by the Addis Ababa Micro and Small scale Enterprises (MSEs) Development Center points out that the problem of access to credit as a key limiting factor for enterprises that want use improved technologies.

Among the alternative sources of funding, leasing can be an effective mechanism for boosting the Ethiopian economy by providing long-term finance to SMEs (World Bank, 2015). Thus, an effective approach to financing SMEs is by supporting leasing companies and other financial institutions that serve these enterprises (IFC¹, 2009). Leasing companies play an important role in the financing of small and medium-sized businesses, which need funds to expand but often do not have the credit history or collateral sufficient for credit from conventional financing sources. Leasing is a highly flexible alternative as a form of financing with several advantages. One of the most important advantages of leasing is that the leased asset itself is the principal security in a lease arrangement. 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 through leasing. Because, leasing gives SMEs the opportunity to create and modernize their operations hence increasing productivity, lowering transaction costs, increasing employment opportunities, increasing business profitability, promoting innovation and creativeness, and increasing product choices (World Bank, 2015).

¹ International Finance Corporation (IFC), the private sector arm of the World Bank, has been active in promoting leasing activity mainly in less developed countries for over 35 years (Global Leasing Report, 2012; IFC, 2009).

While leasing can be traced back thousands of years, the leasing industry has evolved significantly over the past 50 years (Schroth, 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). The number of leasing companies in developing countries has been especially increasing during the last ten years.

The global leasing performance as indicated in World Leasing Year Book (2014) reported that annual leasing volume in 2013 was USD 868 Billion. According to this report, four countries (US, China, Germany and Japan) represented 60% of world leasing volume. The White Clarke Global Leasing Report (2012) also indicated that US is the dominant player in the leasing industry with more than 30% of the world market. The total equipment-leasing industry in the United States is reported by ELFA as \$650 Billion, which is about 5.9% of 2008 real GDP (Schroth, 2010). On the other hand, the African leasing industry is still in its infancy as the region represents around 1% of world leasing volume in 2012 (The White Clarke Global leasing report, 2013).

Leasing has been variously defined in the literature. Bruce (1988)² defined equipment leasing³ as a contract under which one party, the lessor⁴ and owner of equipment, agrees to grant the use of that equipment to another, the lessee⁵, in exchange for periodic rental payments. The accounting definition of a lease is given under ⁶IAS 17: “a lease is defined as an agreement whereby the lessor conveys to the lessee in return for a payment or a series of payments the right to use an asset for an agreed period of time”.

The concept of leasing is based on the proposition that income is earned through the use of assets, rather than from their ownership (World Bank, 2000; Fletcher et. al.,

² The essence of leasing is the separation of property from ownership (Bruce, 1988).

³ This paper refers primarily to equipment or capital goods leasing.

⁴ Lessor as defined by IFC global leasing toolkit is the owner of the leased equipment, which is being leased to a user or lessee.

⁵ Lessee as defined by IFC global leasing toolkit is the user of the leased equipment.

⁶ For companies applying IFRS, the relevant accounting standard is IAS 17 (International Accounting Standard) “Leases” (World Leasing Year Book, 2014).

2005; IFC, 2009). It 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.

In Ethiopia, owing to the need to accelerate the growth and development of SMEs by facilitating access to finance and availing working equipments and machineries to enterprises, the government enacted the first leasing law in 1998, Capital Goods Leasing Business Proclamation No. 103/98. This proclamation was issued to address the equipments and machinery needs of enterprises through lease financing services. Moreover, the service was originally thought to be delivered by lease companies that will be licensed and supervised by the former Ministry of Trade and Industry. Unfortunately, since then no entity was established, at least legally, approved to engage in lease financing business, despite various interests from local and international investors to engage in this business including IFC's proposed "Access Leasing Project" initiatives to establish the first leasing company in the country in 2010 (World Bank, 2012). This situation calls for the need to amend the existing Capital Goods Leasing business proclamation No. 103/98 and authorize appropriate government body that facilitates the licensing and supervision of the lease companies.

To this effect, recently the government has taken measures to address the gap through issuance of revised leasing legislation in 2013, capital goods leasing business (amendment) proclamation No. 807/2013. This proclamation has shown clear demarcation of authority between the Ministry of Trade and the National Bank of Ethiopia meticulously. As a result, the National Bank of Ethiopia (regulatory body of financial institutions) is given the mandate of licensing, regulating and supervising the business of capital goods finance companies which includes financial lease and hire-purchase; and the Ministry of Trade is mandated to license and supervise the

business of operating lease. This has created a more enabling legal and regulatory framework for the formation and operation of lease companies. Accordingly, in early 2014 the National Bank of Ethiopia has issued licenses to five Capital Goods Finance Companies which are established with the support and majority ownership of regional governments and five big MFIs operating in the country. As a result, these five lease finance companies have commenced provision of leasing services in their respective regions since mid of 2014.

Presently, leasing industry in Ethiopia is still at the very early stages of development despite the large potential market in the country. Even if there is an active semi-formal rental market in construction equipment, and car rentals, operating lease has limited role in expanding investment.

1.2. Statement of the problem

Various studies have pointed out that SMEs in Ethiopia have very limited access to bank credit or other financial services (IMF, 2013; World Bank, 2015). This is due to the fact that SMEs possess insufficient collateral or credit history to access more traditional bank finance. A recent study of SME finance in Ethiopia by the World Bank (2015) revealed that only 3% of small enterprises and 23% of medium enterprises have a loan facility or a line of credit mainly due to extreme high value of collateral needed for a loan, corresponding to 249.3% and 253.5% of the loan for small and medium enterprises, respectively against a Sub-Sahara African (SSA) average of 160%.

Owing to the need to bridge this 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 leasing industries. Developing the leasing industry as a means of delivering finance increases the range of financial products in the marketplace and provides a route for accessing finance to businesses that would otherwise not have it, thus promoting domestic production, economic growth, and job creation (IFC, 2005). Moreover, developing leasing allows smaller scale entrepreneurs to become more economically active by enabling access to finance and subsequently, access to income-producing assets. Further, in any

economy, the development of leasing industry positively contributes to the development of SMEs in particular and the economy in general.

However, many countries face structural obstacles in developing a leasing industry: the absence of clearly defined and predictable laws governing leasing transactions, unclear accounting standards, lack of an appropriate tax regime, constrained funding abilities, and the absence of an appropriate regulatory and supervisory framework. Regulations either do not exist or do not take into account the specific characteristics of leasing, or their application and interpretation are uncertain because of a lack of prior experience. Recognizing such weaknesses, governments have turned to IFC for help in laying out the groundwork for leasing development (IFC, 2005 & 2009; GPFI & IFC, 2011). The Ethiopian leasing industry also faces similar challenges, though it needs to be investigated by such study. In addition, this study needs to identify whether there is a mechanism of easy contract enforcement or non-judicial repossession in leasing transaction in Ethiopia.

Studies conducted in different countries of the world (India and Zambia) identified 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). Other problems that may adversely affect the leasing industry includes: lack of expertise in the management; availability of low cost long-term capital sources; absence of well-functioning asset registries and credit bureaus; inadequate tax benefits (World Bank, 2000; Brahmaiah, 1992). Yet, in Ethiopia only few studies (Kemal, 2012) has been conducted to investigate impediments of lease financing which was carried out even before the amendment of the leasing law or before the establishment of lease finance companies in the country.

According to Amembal et. al. (2000) in some circumstances, a separate legal and regulatory framework for leasing companies can be helpful to create a suitable environment for leasing and promote confidence in the industry. Hence, in countries where the leasing industry is still in the very early stages of development, a new legal and regulatory framework could help promote confidence in the efficiency and

fairness of the market. Nevertheless, in Ethiopia, despite the fact that the leasing business has a separate legislation since 1998, no leasing company has been established until 2014. This situation was the main reason to call for the need to amend the existing leasing proclamation in a manner that is appropriate for the formation, regulation and supervision of leasing companies. In addition, the development of leasing industry is not as envisaged in the first proclamation and still at its very infant stages of development due to various reasons.

Few local studies (Kemal, 2012) blame that existence of lack of clarity in tax, legal and accounting aspects of leasing; unavailability of skilled leasing professionals in the market; lack of public awareness and interest in leasing have contributed to the underdevelopment of leasing, however, this local study was conducted before the establishment of lease finance companies in the country or even before the enactment of capital goods leasing business (amendment) proclamation No. 807/2013 and hence, practical challenges were not adequately identified.

Thus, this study assesses the current state of lease financing in the country and investigates the challenges or impediments of the sector. The key areas of assessment include: adequacy and appropriateness of legal and regulatory framework, level of leasing awareness of lessees/SMEs, availability of sustainable funding, and ownership and governance structure and its impact on the performance of the leasing companies.

1.3. Research Objectives

The general objective of the study is to conduct assessment of the current state of lease financing in Ethiopia with particular emphasis on assessment of challenges of the sector as well as legal and regulatory framework towards creating a conducive environment for leasing business.

Specific research objectives include:

- ✓ Assessing the current state of lease financing in Ethiopia in addressing the financing needs of SMEs.
- ✓ Investigating challenges or impediments of the lease finance sector in Ethiopia.

- ✓ Examining to what extent the leasing laws, regulations and directives affecting the leasing business in Ethiopia is adequate, clear and consistent.
- ✓ Evaluating structure of ownership and governance of leasing companies in the country.
- ✓ Identifying relevant Ethiopian laws and regulations that should be harmonized with the recently enacted leasing legislation for the development of leasing industry.
- ✓ Investigate the level of market awareness on benefits and nature of leasing.
- ✓ Assess potential prospects and opportunities of lease financing in Ethiopia.

1.4. Research questions

In view of achieving the objectives of the study and address the research problem, the following research questions are designed:

1. Does the current lease financing services in the country addresses the machinery or equipment financing needs of SMEs?
2. What are the major challenges facing the leasing industry in Ethiopia?
3. What is the profile of structure of ownership of the existing leasing companies and its effect on their performance?
4. Is there a problem of lack of leasing awareness and inadequate understanding of the business posing some challenges on the leasing industry?
5. Are the SMEs in Ethiopia benefiting from lease financing services?
6. What are the factors that stimulate the growth and development of leasing industry?
 - a. Does the current economic growth in Ethiopia contribute to the development of leasing?
 - b. Does the current government attention towards boosting the manufacturing sector create a potential market or prospects for leasing?
 - c. Does the current regulatory reform of leasing creates an enabling environment towards development of leasing?
 - d. Is the existing legal and regulatory framework for leasing adequate, consistent and encouraging investments?
 - e. Is there easy contract enforcement mechanisms for leasing business?
 - f. Do the companies have the required leasing skills and MIS which enable them to efficiently and effectively manage their activities?

1.5. Scope and Limitations

The study mainly focuses on the practice and application of capital goods financing business which include financial leasing and hire-purchase in the Ethiopian context. Hence it does not adequately address the practice and challenges of operating lease business in much detail.

The horizon of the study is limited to assessing the activities of leasing companies or capital goods finance companies licensed and regulated by the National Bank of Ethiopia, with particular emphasis on the supply side. Review of operating leasing practice was not covered in this 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 other limiting factor is the fact that the leasing companies have a practicing experience of not more than a year which constrains to conduct a detailed review of financial and operational trend performance over years.

Presently, there is very limited local research conducted on leasing business in Ethiopia.

1.6. Significance of the study

Lease financing is a new phenomenon in Ethiopia, thus it worth studying. Accordingly, the study is believed to contribute and have a paramount importance in providing a better ground for potential leasing investors, policy makers, practitioners, lessee firms and other stakeholders which are keenly concerned with and engaged in leasing business to take it as a basis for understanding the business in Ethiopian context and serve as a stepping stone for further research on the subject. As indicated in the above section, there is a gap of local publications on leasing phenomenon in Ethiopia.

This work, in addressing this gap, will contribute to the national leasing awareness regarding its nature and benefits to the general public as well as development of the industry through recommendations of activities that will spur the market and minimize impediments of the leasing industry.

1.7. Organization of the paper

Following this introduction section, the rest of the paper is organized in the following manner. Chapter two presents the review of theoretical and empirical literatures on lease financing business including concepts, principles, lesson from other countries, legal and regulatory framework. The third chapter deals with the research methodology employed while chapter four presents findings, discussion and analysis of the study. Finally, conclusions and recommendations of the study were presented in the fifth chapter of the paper.

CHAPTER-TWO

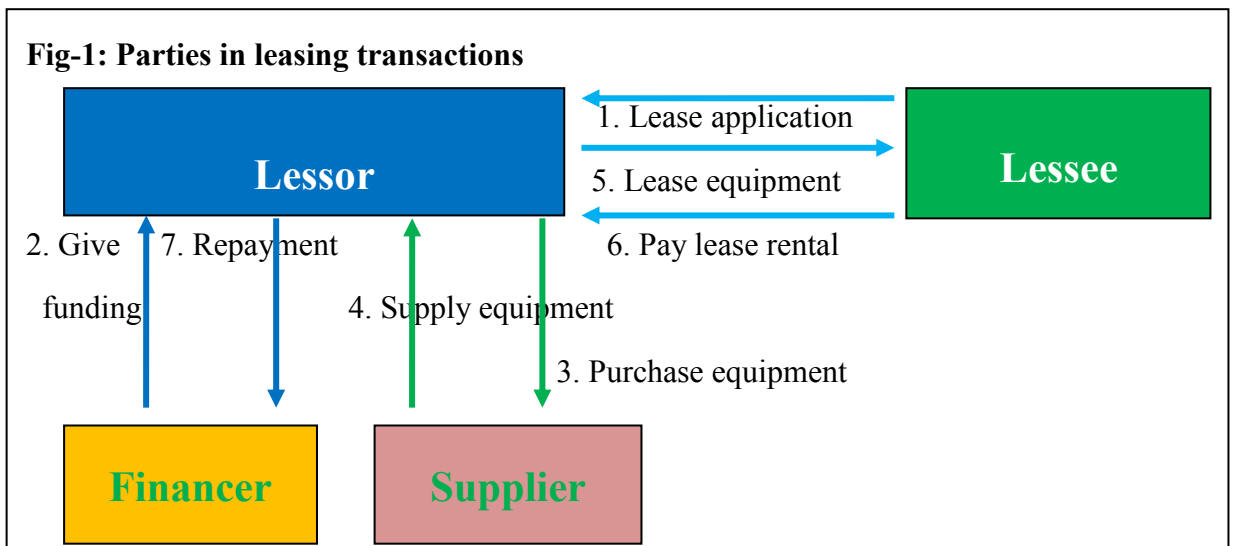
2. REVIEW OF RELATED LITERATURE

This section presents the review of related literature in the area of leasing. It focuses on the concepts/principles, evolution and historical development; debates and approaches to leasing as well as legal and regulatory environment.

2.1. Definition of Leasing

Definitions of leasing differ considerably in different jurisdictions for tax purposes, legal, and accounting: under local and international accounting standards. Leasing has been variously defined in the literature. Bruce (1988) defined equipment leasing as a contract under which one party, the lessor and owner of equipment, agrees to grant the use of that equipment to another, the lessee, in exchange for periodic rental payments⁷.

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 asset⁸ 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).



Source: Kraemer & Lang (2012)

⁷ Rental payment or lease payment is the amount paid per period, typically monthly or quarterly, by the **Lessee** to the **Lessor** in return for the use of the **Asset**.

⁸ The term asset in this paper refers to machinery, equipment and/or vehicles.

IFC (2009) further elaborated the definition that leasing is a medium-term financial instrument for the procurement of machinery, equipment, vehicles, and/or properties. In this sense, it can be argued that leasing has become a source of financing for medium-term investments able to support the development of various sectors of the national economy at competitive financing costs. Leasing provides financing of assets - equipment, vehicles - rather than direct capital. Leasing institutions (lessors) includes banks, leasing companies, insurance companies, equipment producers or suppliers, and non-bank financial institutions - purchase the equipment, usually as selected by the lessee, providing the equipment for a set period of time to businesses.

The accounting definition of a lease as provided by IFRS is “an agreement whereby the lessor conveys to the lessee the right to use an asset for an agreed period of time in return for a payment or series of payments.” IFRS rules are applied to the substance of the agreement rather than their legal form. In other words, IFRS emphasizes the economics of the transaction, its substance, over the legal form of the transaction.

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 lessor⁹ 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. Leasing: Concept and Evolution

While leasing can be traced back thousands of years, the leasing industry has evolved significantly over the past 50 years (Schroth, 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). The

⁹ The proclamation No. 103/98 defines “Lessor” as 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; and “lessee” as a person, under a lease agreement, obtains capital goods from a lessor and has the right to use the capital goods, as against payment of rent for an agreed period of time.

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. The White Clarke Global Leasing Report (2012) also indicated that US is the dominant player in the leasing industry with more than 30% of the world market. The total equipment-leasing industry in the United States is reported by ELFA as \$650 Billion, which is about 5.9% of 2008 real GDP (Schroth, 2010). On the other hand, the African leasing industry is still in its infancy as the region represents around 1% of world leasing volume in 2012 (The White Clarke Global leasing report¹⁰, 2013).

2.3. 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

¹⁰ The White Clarke Global Leasing Report continues a history of tracking the worldwide market for leasing products for more than 30 years.

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.

Leasing institutions can be banks, leasing companies, insurance companies, equipment producers or suppliers (i.e. captive leasing companies), or nonbank financial institutions. These institutions purchase the equipment that has usually been selected by the lessee, and then allow the lessee the use of these equipment and machineries for a specified period of time.

Leasing is often reported to provide a number of benefits to an economy including (IFC, 2009):

- It is a means to deliver increased domestic investment within economies.
- It is a way to deepen the activities of the financial sector by introducing new products and/or industry players and financial instruments.
- It is used as a means of asset financing by all business types from microenterprise to large global company for assets worth ranging from tens of dollars to tens of millions of dollars.
- It provides opportunities for those without a significant asset base: leasing enables small enterprises to leverage an initial cash deposit, with the inherent value of the asset being purchased acting as collateral.
- Allows smaller scale entrepreneurs to become more economically active by enabling access to finance—and subsequently, access to income-producing assets.
- Offers an important advantage in countries with weak business environments, particularly those with weak creditor’s rights and collateral laws and registries—for instance, in countries where secured lenders do not have priority in the case of default over collateral.
- Plays a critical role in bringing in small businesses into the formal financial system: as informal businesses have access to lease financing, they start building a track-record of financial transactions (IFC, 2009).
- Creates access to finance that in turn can create employment opportunities.

2.4. Approaches to Leasing Modalities

2.4.1. Types of Lessors

In different countries various institutions, including banks, are involved in sponsoring lease businesses. Bank-owned leasing companies, nonetheless, dominate the leasing markets as they have the advantage of accessing low cost public deposits as sources of fund.

In most developed lease markets, there are three distinct types of companies sponsoring or offering leasing facilities, namely (IFC, 2009):

1. Banks that offer leasing as part of their product mix through a specialized leasing unit or through their regular lending units.
2. Leasing companies that are subsidiaries of banks or banking groups; typically banks have a significant share in the company
3. Leasing companies that are privately owned and have no bank as a majority shareholder. These companies are often subsidiaries of major equipment manufacturers or dealers, and practice “captive financing”, but there are also many totally stand-alone leasing companies in many countries (IFC, 2009).

Table 1. Comparisons of the three types of lessors

Feature	Bank offering leasing as a product	Bank-owned leasing company	Nonbank-owned leasing company
Dedicated sales team	No	Yes	Yes
Dedicated bank office staff	No	Yes	Yes
Dedicated credit risk department	No	Yes	Yes
Risk policies specifically for leasing	Not usually	Usually	Yes
Fast credit decision making	Not usually	Usually	Usually
Stand-alone information technology platform	Not usually	Usually	Yes
Funding	Self-funded	From bank and other local and international financial institutions (usually with guarantee or comfort from parent)	From local and international financial institutions plus the local or international capital markets
Typical sources of business (in order of individual priority)	Bank customers	Vendors of equipment, Bank customers, and Direct non-bank customers	Vendors of equipment, and Direct customers

Source: IFC Leasing in Development (2009).

According to Leaseurope and KPMG (2012) in World Leasing Year book (2014), 50% of European leasing companies were bank related, 18% captives, and 32% independent in 2010. However, in terms of shares of new volumes “90% of the European leasing market is in the hands of bank-owned leasing companies” (Mignerey, 2012; in World Leasing Year book, 2014).

2.4.2. Types of Leases

Many literatures agree that there are two major types of leases. The value of lease payment as well as risk assessment in lease contract is influenced by the type of lease

agreement. In addition, lease authorities share opinion as to two types of lease (Wright, 2004 cited in Oko and Essien, 2014). These are:

- Finance Lease and
- Operating lease

The key 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;
- Degree (burden) of incidence of risks.

1) Finance Lease

This is also referred to as capital or full pay out lease. It involves the payment of specific sums of money over a period of time as is considered sufficient to amortize the capital investments on the asset by the lessors. According to Ndu (2004), finance lease provides adequately to cushion the lessors' cost of capital, other administrative (running) costs and desired returns on investment.

FAS 13 (as cited in Ross et. al., 2003) states that a lease must be classified as a capital one if at least one of the following four criteria is met:

- i. The present value of the lease payments is at least 90 percent of the fair market value of the asset at the start of the lease.
- ii. The lease transfers ownership of the property to the lessee by the end of the term of the lease.
- iii. The lease term is 75 percent or more of the estimated economic life of the asset.
- iv. The lessee can purchase the asset at a price below fair market value when the lease expires. This is frequently called a bargain-purchase-price option.

2) Operating lease

Operating lease unlike the finance lease does not provide for the full amortization of asset within the primary tenure of the lease. So, leases not meeting the abovementioned criteria are called operating leases.

As explained above, although generally leases are classified into two major types, in some countries there is a third product type called hire-purchase having similar features with leases. According to Kraemer & Lang (2012), in many statistics, leasing is combined with hire-purchase. The term hire-purchase covers different types of contracts from country to country. In some cases, hire-purchase involves the transfer of ownership of the asset at the end of the contract, either automatically or through the exercise of a purchase option. These types of hire-purchase contracts are therefore leases (i.e. in the UK, Germany, Poland and the Netherlands). However, in cases where ownership transfers at the beginning of the contract, these types of contracts are closer to an installment credit contract than a lease. Similar to the former point, world leasing year book (2014), indicated that due to the wide-spread adoption of Hire-purchase as a finance mechanism and the fact that in some countries hire purchase has become the major source of revenue for leasing companies, the national leasing associations came to a consensus that in future years, hire-purchase should be included in the total leasing volumes.

ILO (2003) articulated that “hire-purchase, which is similar to a finance lease, is a way to finance the purchase of equipment. It is normally used for small items like sewing machines and fridges. In hire-purchase, part of the ownership is transferred with each payment. Up on payment of the last installment, the lessee becomes the full owner.”

2.4.3. Feature of Finance Lease versus Operating Lease

The key differences between the finance lease and the operating lease are summarized in table-2 below (IFC, 2009):

Table 2. Features of Finance Lease Versus Operating Leases

Feature	Finance lease	Operating lease
Legal ownership	Lessor	Lessor
Right to economic usage	Lessee	Lessee
Responsibility for insuring asset	Lessee (although lessor may organize this and then recharge lessee)	Lessor (some transactions may stipulate the lessee)
Responsibility for maintenance of asset	Lessee	Either the lessee or the lessor, with the responsibility agreed on when the lease contract is signed
Transfer of ownership at end of lease	Lease agreement will typically include a condition of transfer of ownership. Normally, legal ownership of the asset will be transferred to the lessee at a nominal charge; however, the parties may agree that the lessee return the asset to the lessor with no financial benefit being received by the lessee	Lessee has no rights of ownership at the end of the lease; it returns the asset to the lessor, which will either sell the asset to a third party (retaining all of the sale price) or lease the asset to a new lessee
Choice of asset supplier	Lessee	Lessee (unless the asset is already owned by the lessor)
Balance sheet treatment	Leased equipment is normally treated as an asset of the lessee, which will claim all fiscal depreciation allowances as though it were the legal owner, lessor has a receivable on its balance sheet equal to the future capital repayments owed by the lessee	Leased equipment is normally treated as an asset of the lessor, which will claim all fiscal depreciation allowances as the legal owner operating leases are normally treated as “off-balance sheet” items for lessees
Profit and loss account treatment	Lessee depreciates asset and records the interest element of each lease repayment as an expense; lessor will enter the interest element received from the lessee as income	Lessee enters the total leasing repayment as an expense, lessor enters the total leasing repayment as income

Source: IFC Leasing in Development, 2009.

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:

i. 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.

ii. 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.

iii. 100% 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.

iv. 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.

v. No risk of fund diversion

In leasing, the funding provided goes to the purchase of equipment without even passing through the hands 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).

2.6. Enabling Environment for Leasing: Legal & Regulatory framework

According to World Bank (2004) an enabling environment is crucial for the development of leasing as for any economic activity. Two crucial elements are clear legal basis and minimal regulation. The use of internationally accepted accounting standards and a tax code that is not biased against leasing would further enhance leasing sector development. Additional factors such as a clear property rights regime, adequate creditor protection, and well-functioning asset registries and credit bureaus (that enable financial activity in general) also contribute to the development of a strong leasing market.

2.6.1. Legal Framework

World Bank (2004) study revealed that in most countries the civil code provides the legal basis for leasing. Some countries such as United States, France, Argentina, Brazil, Russia, Korea, Indonesia, Morocco, and Ghana have specific leasing laws. Tajikistan, Uzbekistan, and Kyrgyz Republic have recently enacted leasing laws with support from IFC. Whether provided by a specific leasing law or by the general civil code, the effectiveness of the legal framework will depend on the following key elements:

- Clarity in defining a lease contract, leased assets, and responsibilities and rights of parties to a lease contract:
- Liability
- Priority of lessor's claim over leased asset:
- Repossession: Easy and fast repossession of leased assets is one of the main advantages the lessor has compared with the lender. The legal framework

should permit non court repossession, so that lessors can repossess leased assets without going to court as long as the lessee does not contest the repossession (World Bank, 2004).

2.6.1.1. Fundamental Elements of Financial Leasing law

According to Amembal et. al. (2000) in some circumstances, a separate legal and regulatory framework for leasing companies can be helpful to create a suitable environment for leasing and promote confidence in the industry. Many developed countries, despite their long history of leasing, do not have a separate leasing law. Those countries usually have well-developed common and civil laws that provide an adequate basis to support leasing transactions. In countries where the leasing industry is still in the very early stages of development, a new legal and regulatory framework could help promote confidence in the efficiency and fairness of the market.

Fundamental elements of efficient financial leasing comprise (IFC, 1998):

- Freedom of contract
- Recognition of the three-party structure of the modern financial lease
- Duties consistent with party's role in the transaction
 - Lessee's duty to pay after acceptance
 - Lessor's lack of equipment responsibilities
 - Lessee's recourse against the seller
 - Equipment not liable to other creditor's claims
 - Transfer freedom and restraint
- Default remedies, including the right to accelerate the remaining lease payments
- Expedient repossession and recovery

In the contractual agreement the rights and duties of the lessor as legal owner of the asset and the rights and duties of the lessee as user of the asset should be clearly stated. The legal owner needs a clear, simple, workable, timely process to

reclaim an asset if the terms of the lease are breached by the user, including the automatic right of repossession without lengthy court proceedings and the right to claim payments due and other damages. The lessee must have the right to use the asset unimpeded and gain the full productivity of the asset. In some countries, it may be necessary to clarify that the lessee does not have the right to create a lien on leased assets (IFC, 1996).

2.6.2. Regulatory framework for Leasing

Prudential requirements for lessors are generally less stringent than those for banks, because lessors are not usually allowed to attract deposits. Nevertheless it is in the interest of shareholders as well as lessees that there are minimum prudential requirements. This helps to maintain a stable and vibrant leasing industry (ILO, 2003).

The regulation and supervision of lessors is usually vested in a country's Central Bank or Ministry of Finance. The regulating authority will spell out certain financial and administrative requirements for all leasing companies. According to ILO (2003), the most common of these are:

i. Minimum capital requirements

Financial institutions and banks are required to have a minimum amount of capital. Capital requirements for leasing companies are normally lower than those for banks.

ii. Maximum debt to equity ratio

The debt-equity ratio compares the amount of capital borrowed by the lessor with amount of capital injected by shareholders. It is advisable that this does not exceed 10:1, meaning that no more than 10 units of capital should be borrowed for every unit invested by the shareholder. The 10:1 maximum ratio was recommended by the International Finance Corporation after many years of experience in leasing ventures throughout the world (IFC, 1996).

iii. Standardized financial statements

Financial statements are a means by which external parties can evaluate the financial health of the lessor. To stabilize the leasing industry in the country, the regulatory authority may make specific rulings concerning the presentation of the lessor's financial statements.

iv. Foreign Exchange and customs

Lessors need to be able to freely convert local currency into foreign exchange. This enables them to buy equipment with foreign currency while setting lease payments in local currency. It is important that any customs duty that lessors pay on imported equipment is the same or less as would be paid by the entrepreneurs if they imported the equipment themselves. Many countries have adopted favourable regulation regarding customs duty in leasing.

2.7. 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-alones 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).

2.8. Lease Accounting & Recent Changes

With regards to the accounting treatment of leases, the Financial Accounting Standard Board's (FASB) Statement of Financial Accounting Standards No. 13- a ruling issued in November 1976 establishing standards for the financial statement treatment of operating and capital leases according to US Generally Accepted Accounting Principles. The international standard is IASB 17 (IFC Global Leasing Toolkit, 2010).

Within IFRS, the accounting standard that governs the treatment of both financial and operating leases for financial accounting purposes is International Accounting Standard (IAS) 17 (IFC Global Leasing Toolkit). As mentioned in the same toolkit, IFRS and IAS 17 are finding increasing acceptance world-wide. It is also expected that most countries which currently use national accounting standards will adopt IFRS over the next three to five years. Moreover, according to IFC (2009), of the various standards that address the issue of accounting for leases, IFC encourages the adoption of IAS 17.

The methods of accounting for leases have been under review as a joint project of the FASB and the International Accounting Standards Board (IASB) since 2006 and the two organizations issued substantially identical discussion papers in March 2009. Their proposals may change significantly before adoption, but a central feature is elimination, in lessee accounting, of the distinction between capital leases and operating leases: lessee will be required to capitalize all leases for the lease term (Schroth, 2010).

Recently, the IASB and FASB (collectively, the Boards) have issued their revised exposure draft (revised ED) on leases in June 2013 (Ernst and Young, 2013). The revised ED proposes a new accounting model for leases that would affect both lessees and lessors. The Boards propose requiring lessees to recognize assets and liabilities arising from their involvement in most leases. Thus, the Boards continue to

propose putting most leases on lessees' balance sheets. All entities would classify leases to determine how to recognize lease-related revenue and expense. The lease classification criteria would be based on the portion of the economic benefits of the underlying asset that are expected to be consumed by the lessee over the lease term. Classification also would affect what lessors record on the balance sheet.

2.8.1. Tax issues of Leasing Businesses

Income or profit tax and value-added taxes (VAT) are two major taxes that have significant implications for leasing. Actual impact of taxes on leasing is however much more complicated. Deelen et. al. (2003) discuss some additional taxes (capital gains tax, property tax, stamp duty, etc.) which impact leasing in some countries.

Income or profit tax: Two factors of particular relevance are: a) whether lessors are allowed to deduct depreciation (and lessees deduct lease payments) from their taxable income; and b) whether accelerated depreciation is permitted. The first factor depends on whether a country follows a "form" approach or "substance" approach towards lease taxation. In "form" countries, lessors can deduct depreciation only if a lease satisfies criteria specified in the tax regulations that qualify it as a 'true lease.' As for (b), some countries permit lessors to depreciate the leased asset over the lease period (typically shorter than the economic life period over which normal depreciation is allowed). This further increases the tax-gains because taxes are deferred (and thereby have lower present value).

One of the advantages of leasing is that it allows the lessor to use depreciation as a tax-shield. Additionally, the lessee gains from the larger-tax shields arising out of deducting lease rentals rather than interest on a loan and depreciation on equipment. Operation leases automatically benefit from the typical tax treatment of leasing. "Form" approach to lease taxation encourages leasing since it allows even full-payout leases to obtain tax savings usually associated with leasing. This is especially relevant to developing economies where simple finance leases form the major proportion of leasing, and particularly for microenterprises and SMEs that are more likely to use finance leases rather than operating leases.

Although, using form approach results in governments foregoing tax revenue, the gains to the economy from higher investments resulting because of the favourable treatment could be larger. It is also worth noting that adoption of IAS-17 for accounting purposes (which requires lessees to capitalize all finance leases) does not restrict the use of the form approach for taxation purposes. This would only require lessors and lessees to maintain an additional set of accounts for taxation purposes and reconcile it with their primary accounts (Boobyer, 2003).

The most common arrangement is for lessor to pay VAT during equipment purchase, and for lessee to pay VAT on lease payments and on value of the asset if ownership is transferred at the end of the lease period. Amembal (2000) recommends waiving VAT on lease payments in emerging markets since in these markets most leases are simple finance leases that are close substitutes for term-loans; VAT is typically not charged on loan payments. Westley (2003) also argued that loans and finance leases need to be treated similarly for tax purposes (since they are close substitutes).

Thus, VAT has a profound impact on the leasing business. According to the IFC (2009), the tax treatment of leases for both the lessor and the lessee is a major determinant of whether a country develops leasing as a successful financial product. As per the IFC's assessment, countries with laws that create no noticeable tax treatment differences between finance leasing and bank loans have the most vibrant leasing sector. What matters most is the existence of a level playing field between leasing and other forms of credit. It is a plain fact and for policy reasons, governments should retain the right to introduce preferential tax treatment to the leasing business in the interests of encouraging domestic investments in the economy (IFC, 2009).

2.9. Estimating potential size of the lease market

According to IFC (2008), in the absence of adequate statistical information on leasing transactions, the leasing experts uses three methods to estimate the potential size and growth of the leasing market. These methods are as follows:

- Leasing as a percentage of capital goods imports
- Leasing as a percentage of GDP

- Leasing as a percentage of bank lending
 - i. Leasing as a percentage of capital goods imports

In estimating the size and growth of the leasing market using leasing as a percentage of capital goods imports, leasing experiences in some developed and emerging markets suggest that, in more developed leasing markets lease finance accounts for between 20 – 30 percent of capital goods imports while for developing economies leasing as a share of capital goods imports ranges between 10 – 20 percent (IFC, 2008). For example, in a developing country with low levels and sophistication in leasing like Ghana, IFC estimated 15% of capital goods imports in Ghana as leasing.

- ii. Leasing as a percentage of GDP

Typically leasing accounts for about 0.5 – 2.0 percent of GDP for less developed economies and about 2 – 5 percent for more developed economies (IFC, 2008). In 2008, IFC estimated that 1.5 percent as the contribution of leasing to Ghana's GDP.

- iii. Leasing as a percentage of bank lending

In developed economies approximately 15 -20 percent of the market for bank loans can be attributed to leasing while for developing economies it is fair to estimate that leasing will form about 5 – 8 percent of total lending. Similarly, in 2008 IFC estimated that 6 percent of the bank lending as share attributed to leasing in Ghana. In calculating bank lending to the private sector, the outstanding credit to the private sector provided by the central bank which gives an indication of the net amount of lending to the private sector at any given period is used.

2.10. Lesson from other country's Leasing Experience

2.10.1. Sri-Lankan Leasing Experience

The leasing experience of Sri-Lanka was assessed due to the reason that the country is among one of the developing economies with long years of leasing experience. The leasing industry in Sri-Lanka has been in operation since 1980 and it started with transport sector after the government made decision to privatize same. The business was introduced mainly to switch the gap of transportation sector problems with a primary purpose of supporting the SME segment. Consequently, the operations of vehicle leasing

were started by three Specialized Leasing Companies that forms the leasing industry at the moment. Currently, the demand for leasing as a source of finance was increased with the economic development of the country leading to a significant increase in leasing industry.

The Central Bank of Srilanka (CBSL) is responsible to regulate and supervise the leasing industry in the country. The lease products are provided mainly through two institutions i.e. Finance Companies and Specialized Lease Companies. To this end, while they are similar in most aspects, finance companies are allowed to mobilize deposit from the public while specialized lease companies are not allowed to do so. As at end of December 2013, there were 59 Leasing Companies - 48 Finance Companies and 11 Specialized Lease Companies (CBSL Report, 2013). Though the lease companies are allowed to do operating lease under same license, only few institutions do provide operating lease. Moreover, the share of operating lease to the entire lease portfolio is deemed to be very low i.e. < 5%.

The following issues/facts characterize the leasing sector in Sri Lanka:

- Leasing sector in Sri-Lanka is driven by vehicles market i.e. it constitutes around 90% of the total lease portfolio of the country. The reason behind same was stated to be:
 - unlike machinery, price of vehicles appreciates at time of sale,
 - relatively, enforcement of nonperforming assets is very easy,
 - court procedure is not required for vehicles (lessors can possess it straight away from the road)
 - there exists vehicle registry,
 - a vehicle is relatively more saleable asset in secondary market,
 - ease of disposing the asset
- Machinery lease facility is granted mainly for credit worthy and corporate clients;
- Leasing industry has been very lucrative i.e. it has a higher rate of Return on Asset than commercial banking business. In addition, 90% of the lease companies are deemed profitable.
- Lease period varies from a period of 1 year to 5 year.

- Depending on the level of credit worthiness of the lessee and the type of leased asset, leasing companies may require different level of down payments for the leased asset. For e.g. if they think that the value of the repossessed asset depreciate over time, then, they charge higher percentage of down payment.
- Though there is no hard and fast rule, Lease companies, apart from the leased asset itself, use personal guarantors of the lessee as additional cushion to minimize the risk of default.

2.10.2. Regulatory and Supervisory practice of Leasing in Sri Lanka

Leasing companies are generally governed by the Finance Business Act (2011) and Finance Leasing Act (2000). The Department of Supervision of Non-Bank Financial Institutions of the Central Bank of Sri Lanka carries out the regulatory and supervisory functions in respect of Licensed Finance Companies and Specialized Leasing Companies, to ensure the compliance of these institutions with the minimum prudential requirements stipulated by the Central Bank. These functions are carried out mainly through off-site surveillance and on-site examinations (Central Bank of Sri Lanka Regulation-Book, 2013).

The law empowers the Department of Supervision of Non-Bank Financial Institutions of the Central Bank of Sri Lanka to undertake the following tasks:

- ✓ Issue prudential directions, regulations, guidelines;
- ✓ Grant approval for issuing debt instruments;
- ✓ Grant approval for opening/closure/shifting of specialized leasing company branches and business places;
- ✓ Conduct off-site and on-site examination and the enforcement of regulatory action;
- ✓ Grant approvals for structural changes (establish any subsidiary or associate company, enhance or reduce its issued capital, sell specialized leasing company's/subsidiary's business or part of business, change of Board of Directors and CEO, change of name and etc) of specialized leasing company etc.

Sri Lankan leasing industry is composed of two types of companies i.e. Licensed Finance Companies (LFC) and Specialized Leasing Companies (SLC) (Central Bank of

Sri Lanka, 2013). Both companies provide identical service however they differ on ways of mobilizing funds to meet the growing demand of their clients.

- 1) Licensed Finance Companies: are a lease companies accredited by CBSL to undertake lease business through deposit mobilization from a general public. Besides, they can mobilize funds through borrowing, debenture, money market, securitization and other available means accredited by the CBSL.
- 2) Specialized Leasing Companies: are types of Leasing Companies legally operating in Sri Lanka. Companies in this category are not allowed to mobilize deposit from the public. However, they can borrow from banks, issue debentures and use money market line.

Companies under both categories are subject to prudential regulation because, they are public companies and subject to 'Public Accountability'. The degrees of accountability in both companies are quite different. In view of this and to establish balanced regulatory framework, two separate acts were enacted, Finance Business Act (FBA-2011) and Finance Leasing Act (FLA-2000). In terms of the FBA, the Monetary Board is empowered to issue directions, rules, determinations, notices and guidelines to Licensed Finance Companies (LFC) and the Director of the Department of Supervision of Non-Bank Financial Institutions is empowered under the FLA to issue directions to the Registered Finance Leasing Establishments (RFLEs).

2.11. Empirical Evidence

Ahmed et al. (2003) conducted a research entitled Leasing Industry in Pakistan: Problems and Prospects. The main objective of this paper was to identify the major issues adversely affecting the performance of leasing sector in particular and financial sector in general. Accordingly, the study tried to identify two general issues pertaining to macroeconomic scenario and four specific challenges of the leasing companies in Pakistan. Regarding the first two general issues the paper discusses in detail about the adverse effect of economic slowdown and volatility of interest rate on the activities of financial institutions including leasing companies. On the other, the four specific challenges explained in the paper include: resource constraints (funding problem), non-

availability of level playing field, lack of innovative products and tax related challenges. It was also argued that in order to improve the near future demand prospects of the leasing sector in particular, the leasing companies need to develop innovative products along with encouraging leasing of plant and equipment relating to priority sectors of the economy including energy, IT (computers and other hardware), textiles, etc subject to their intrinsic value.

Alyosius and Lubinda (2013) in their study of the development of Leasing Industry in Zambia tried to assess the development and challenges of the same. The paper has three objectives. The first objective was to determine the trends of the leasing industry in Zambia. The second objective of the study was to assess the contribution of the legal and regulatory framework to the development of the leasing sector in Zambia. Finally, the study sought to highlight the major challenges faced by the leasing market in Zambia. The study employed a qualitative research approach and used primary data from nine non-bank leasing companies, Bank of Zambia officials and Ministry of Finance officials. Secondary data was gathered from various financial sector and leasing publications, reports and dissertations. The result of the study revealed that the prudential performance of the sector has been unsatisfactory. The study revealed that the industry performed average in capital adequacy, but performed poorly in asset quality, earnings and liquidity performance. It has also found out that the regulatory system in Zambia was still fragmented and operating in an environment with insufficient legislation. The study further revealed that the regulatory body had not yet put enough effort in promoting leasing markets in Zambia. The study noted that there is no leasing industry specific legislation in the country. The main regulator, Bank of Zambia, lacked technical and supervisory capacity to adequately supervise the industry. According to the study, the major challenges experienced by the lease providers in Zambia included the lack of leasing policy and leasing laws, lack of skilled staff, absence of resident leasing trainers and poor supply chain systems that exist in the country. On the other hand, the study didn't included key leasing stakeholders such as tax authority, investment agencies, equipment suppliers to strengthen and validate the findings.

Brahmaiah (1992) carried out a research on the problems and prospects of leasing industry in India. The paper aims to examine the problems faced by leasing companies in India and to assess the prospects of the Indian leasing industry. The study is conducted

based on 28 lessors' questionnaire-response and the outcome of the in-depth interviews of the executives of leading leasing companies. According to the study, there were over 400 private and public limited leasing companies in India involved in diverse leasing activities. Moreover, the study tried to explain the different formation and structure of leasing companies in the country. The paper divides the sector into two broad categories: the private sector leasing and the public sector leasing. The important constituents of the private sector leasing industry include: Pure Leasing companies, Hire-purchase and Finance companies, and Subsidiaries of Manufacturing Group companies. On the other hand, the public sector leasing organizations are divided into (a) leasing divisions of financial institutions; (b) subsidiaries of nationalized commercial banks; and (c) other public sector leasing organizations. After thorough analysis of the leasing industry, the study has identified the main problems that require utmost attention. These are: resource crunch; inadequate tax benefits and sales tax burden; rigid procedure for import/cross-border leasing; lack of proper and integrated accounting standards; lack of legislation; existence of cut-throat competition; and lack of expertise in the management. With regards to the prospects of leasing industry in India, the paper noted that despite the abovementioned problems, the leasing business in India has its own growth potential and prospects. It has also described the potential of leasing in India by comparing the level of total industrial investment through leasing (less than 1 percent) with that of developed countries such as the US, the UK (30 – 40 percent capital investment through leasing) and 10 to 20 percent in Australia, Canada, Japan, etc.

Although various empirical studies have been conducted to assess the problems and prospects of leasing industry in different countries of the world, there is a dearth of empirical study that examines the data on leasing aspects particularly in Ethiopia. Therefore, this study will make an attempt to bridge this gap and elaborate the opportunities, potential prospects and challenges of the leasing industry in Ethiopia.

2.12. Conceptual Framework

As emphasized in chapter one, the main objective of the study is to assess the current performance, prospects and challenges of leasing industry in Ethiopia including

assessment of legal and regulatory framework towards creating a conducive environment for leasing business. In the literature review section, various concepts and aspects of leasing development have been addressed. Creswell (2009) suggests that after summarizing and assembling the literature review, structuring it thematically or organizing it by important concepts to end the literature review is commendable. Accordingly, in view of the various literatures reviewed in the foregoing section, the following conceptual framework is developed to provide a rationale for the study.

Fig-2: Conceptual Framework

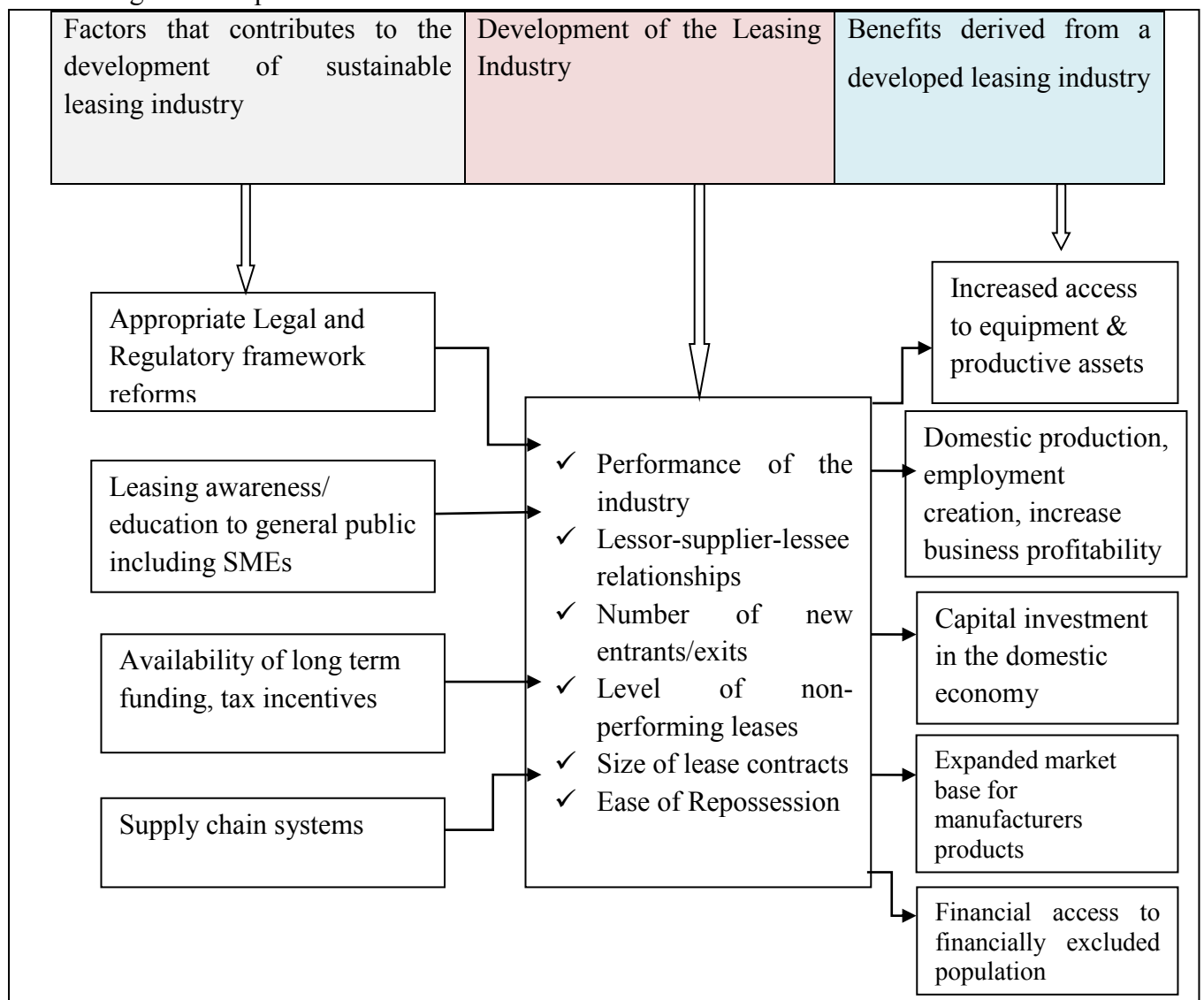


Fig-2: Modified and adopted from Aloysius and Lubinda (2013).

CHAPTER-THREE

3. RESEARCH METHODOLOGY

3.1. Research Design

The aim of this study is to get insight of the current performance, prospects and challenges of leasing industry in Ethiopia including assessment of the current legal and regulatory framework. According to Creswell (2003), there are three methods that are used in conducting a given research. These are qualitative, quantitative and mixed approaches. This study employed a mixed research approach which encompasses both quantitative and qualitative methods. Exploratory research design was also used to gain new insights about the leasing phenomenon in the country. Thus, the study attempted to explore the experiences of the leasing experts, CEOs of leasing companies, selected officials of MOT, EIC and FeMSEDA.

3.2. Population

The population of the study covers all lease finance providers in Ethiopia, regulatory bodies, and key stakeholders engaged in development of leasing. The central focus of the study will be on the five leasing companies that are licensed and regulated by the National Bank of Ethiopia. Thus, the study population of leasing companies (or capital goods finance companies) comprises Addis Capital Goods Finance Company, Oromia Capital Goods Finance Company, Waliya Capital Goods Finance Company, Debub Capital Goods Finance Company and Kaza Capital Goods Finance Company. The head offices of the first two companies are based in Addis Ababa while that of the remaining three companies stationed in Bahir-dar, Hawassa, and Mekelle towns, respectively.

The regulatory and supervisory agencies included in this study are the National Bank of Ethiopia and the Ministry of Trade (including Addis Ababa Trade Bureau). On top of this, the key stakeholders working with the leasing companies include the Federal Micro and Small Enterprises Development Agency, International Finance Corporation (IFC), Ethiopian Investment Commission and Ethiopian Revenue and Customs Authority.

3.3. Sample Design

Full census is used since the current number of the lease finance companies is only five. Thus, all the five leasing companies that are licensed and regulated by the

National Bank of Ethiopia were included in the study not only due to small size but also due to the fact that they represent five different regions including Addis Ababa. Besides, the regulatory authorities involved in the regulation and supervision of leasing that include National Bank of Ethiopia and Ministry of Trade were also included in the sample.

A mix of both random and purposive sampling was used in identifying the respondents. The employees of the five leasing companies have been included in the study by use of random sampling method while the CEOs are purposely included. In addition, purposive sampling was used to select respondents from employees of regulatory authorities, EIC, FeMSEDA, ERCA based on their familiarity with the issue (starting from the establishment of the five leasing companies) as well as leasing professionals who are experts in the field.

3.4. Data and Collection Instruments

The study used both primary and secondary data. Primary data was sourced through questionnaire and interviews. Secondary data was collected from various available publications, company reports, memorandum & article of association of companies, proclamations, and regulations. Besides, crucial information and published documents related to legal and regulatory framework of leasing was collected from the National Bank of Ethiopia, Ministry of Trade and Ethiopian Investment Commission.

The detailed descriptions of the data collections instruments used are presented as follows:

3.4.1. Questionnaire

In order to source primary data from respondents, a structured questionnaire was developed incorporating eight focus areas that include background information of respondents, their attitude towards adequacy and appropriateness of current legal and regulatory framework of leasing; ownership and governance structure; types of products and equipments leased; supply chain systems; prospects of leasing sector;

level of leasing awareness; and challenges of the lease finance sector in Ethiopia. The five point Likert rank order scale measurement was introduced in the questionnaire to request respondents to indicate their level of agreement with the following ratings: Strongly Agree (SA; or 5), Agree (A; or 4), Neutral (N; or 3), Disagree (D; or 2), and Strongly Disagree (SD; or 1). Accordingly, the questionnaire that comprises 63 structured questions and 3 open ended questions were distributed to 45 employees of five leasing companies licensed by NBE, and key leasing stakeholders including staff of MOT (and employees of Addis Ababa Trade Beaura), NBE, EIC, and FeMSEDA as well as selected leasing experts. A mix of both random and purposive sampling was used to select the respondents. The selection of respondents was made in a manner to represent the management and staff of leasing companies as well as to include key leasing stakeholders and leasing professionals working in the industry. All the CEOs of the leasing companies was purposely included since they have been involved in knowledge exchange visits to other countries as per the information obtained from the NBE. Fortunately, out of 45 questionnaires, 42 were returned due to efforts made and continuous follow up to collect the completed questionnaires. As a result, 42 questionnaires have been fully completed and returned for use in the study. The responses have been analyzed in chapter four using recent versions of SPSS.

3.4.2. Key Informant Interview

Key informant interview was conducted with principal leasing professionals who have had practical leasing experience in other countries and now based in Ethiopia, selected CEOs and senior staff of the five leasing companies, and international leasing experts particularly those working with IFC. On top of this, in-depth interview was also conducted with senior officials of key leasing stakeholders including NBE, Ministry of Trade, ERCA and FeMSEDA. The interview allows the researcher 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.

In the process of preparing, testing and using the instruments, the following procedures have been followed:

- a) The questionnaires and the interview guides was developed based on review of literature relevant to the issue and the specific objectives.
- b) Both tools were judged for their validity using leasing experts.
- c) Finally, the questionnaires and interviews were administered by the researcher.

3.4.3. Document Review

The most recent leasing publications (including World Leasing Year Book), company policies and manuals, leasing laws, regulations and directives related to leasing business were consulted.

3.5. Method of data analysis

The data collected through the questionnaires were analyzed through descriptive statistics that involves frequency distribution, percentages, cross tabulation, bar chart and/or pie charts. The 23rd version SPSS (Statistical Package for Social Science) was used to generate the data statistics. For this study, descriptive statistics is chosen because of its simplicity and clarity to draw inferences. Averages, percentages, diagrams, and tables of legal framework of leasing, level of leasing awareness; structure of ownership of leasing companies and challenges of the leasing industry was also analyzed.

The secondary data was analyzed quantitatively while the primary data obtained through open-ended questionnaires, key-informant interview and document review is interpreted qualitatively and summarized in line with respective theme against the background of the research questions and objectives.

3.6. Validity of the study

Validity refers to the degree to which a study accurately reflects the specific concept that the researcher is attempting to measure or describe. In order to keep the validity of the study, researchers should be concerned with both external and internal validity

(Grix, 2004). Yin (1994) suggested using multiple sources of evidence as the way to ensure construct validity.

Thus, in addition to all the lease providers in five different regions of the country, the researcher has made efforts to include the views and opinions of key leasing stakeholders (EIC, FeMSEDA, IFC and ERCA) and regulatory bodies such as NBE and MOT, leasing professionals, etc. to ensure the validity of the study. Since questions are tested up on their clarity and understandability and significant conclusions are drawn using those questions, it adds both to the internal and external validity of the study. In order to keep the validity, the researcher chose representative respondents which are familiar with the issue and are experts in the subject, which enhance the external validity of the result.

CHAPTER – FOUR

4. FINDINGS, DISCUSSIONS AND ANALYSIS

This chapter explains and discusses the results of findings based on the analysis done on the data collected. The results of the study are discussed by triangulating the different sources results such as questionnaires results, key informant interview as well as document review results. The discussion attempts to accomplish the objectives of the study and answer the research questions.

A total of 45 questionnaires which consists 63 closed ended and 3 open ended questions were distributed to all lease finance companies, key leasing stakeholders, regulatory bodies and selected leasing experts. From the total questionnaires, 42 were fully completed and returned for use in this analysis due to efforts made and subsequent follow up to collect the distributed questionnaires. Hence, only three questionnaires were not collected. The survey respondents were located in Addis Ababa, Amhara, Oromia, SNNP and Tigray regional states.

4.1. The current state of Lease Financing in Ethiopia

Lease financing is a new phenomenon in Ethiopia and yet at its infant stage of development. Although the first leasing law, i.e. Capital Goods Leasing Business Proclamation No. 103/1998 was issued in 1998 or eighteen years ago, leasing business has not developed as envisaged in the law. The law was issued to address two major gaps: i) to create an enabling environment for the establishment of alternative sources of funding for those entrepreneurs that lack capital; ii) to fill the existing financing gap which was not addressed by the existing financial institutions. This proclamation details the three major types of leasing that include: operating lease, financial lease and hire-purchase. However, except operating lease, the two products (financial lease and hire-purchase) were not practiced formally in Ethiopia. Existence of this gap coupled with the government's need to support the development of manufacturing sector and industrialization of the country, lead to the coming into effect of amendment of capital goods leasing proclamation No. 807/2013 during end of July 2013. Following the enactment of the amended proclamation, the NBE, regulatory body of financial institutions, licensed five lease finance companies that operates in five different regions of the country. Accordingly, the five leasing companies, namely: Addis CGFC, Oromia

CGFC, Waliya CGFC, Dehub CGFC and Kaza CGFC, obtained capital goods finance business license in 2014 and currently operating in Addis Ababa, Oromia, Amhara, SNNR, and Tigray regions, respectively. The major shareholders of these leasing companies are regional governments and the five big MFIs in the country (see section 4.2.3). So far, there is no private or foreign leasing companies joined the sector, albeit there are some interests from foreign investors to engage in leasing business as per the information from the NBE.

4.1.1. Distribution of leasing portfolio

As at December 31, 2015, the lease finance sector extended a total capital goods finance of Birr 89.5 million. Among the five leasing companies, Oromia CGFC provided the highest share (53.2%) of capital goods finance of Birr 47.6 million followed by Addis and Waliya with a share of 28.2% and 18.2%, respectively (see table 3 below). One of the main reason for constituting the lion's share by Oromia CGFC is due to the fact the company has financed big turn-key projects, which is a government driven project. Actually, all leasing companies except Addis CGFC have started financing of such projects, though they have not yet signed the lease agreements with the lessees.

Table-3. Distribution of lease portfolios as at December 31, 2015

(in '000s of Birr)

No.	Regions	Name of Leasing Companies	Capital Goods finance/ Lease Portfolios	Percentage
1	Addis Ababa	Addis CGFC	25,270	28.2
2	Oromia	Oromia CGFC	47,642	53.2
3	Amhara	Waliya CGFC	16,292	18.2
4	SNNR	Dehub CGFC	326	0.4
5	Tigray	Kaza CGFC	-	-
	Total		89,530	100

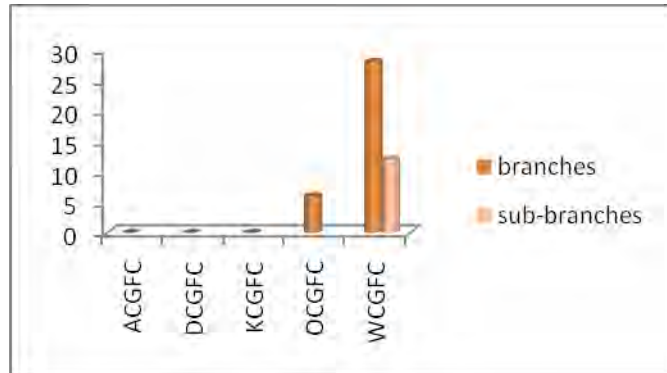
Source: Own compilation from reports of the companies

As can be observed from table-3 above, Kaza CGFC has not yet reported capital goods financing amount in its balance sheet, but it has already started processing of the leasing operation primarily in financing of turn-key projects. Yet, the signing of the lease agreements has been delayed for different reasons, as per the interview result.

4.1.2. Branch Network of Lease Finance Companies

Lease finance sector constitutes 5 Capital Goods Finance Companies having 34 branches and 12 sub-branches in four regions and one city administration (during end of December 2015).

As illustrated in the graph, Waliya CGFC has the largest branches accounting 28 branches and 12 sub-branches followed by Oromia CGFC with 6 branches. The remaining companies have not yet opened an outlying branches and operating at their head office branches. So far, the sector has



provided capital goods financing services to 777 lessees. This number is very small compared with the SMEs' demand for machineries and equipments assessed by the leasing companies as per the interview result with selected CEOs.

4.1.3. Current Performance of Lease Finance Companies

As can be seen from table-4 below, the total assets of the lease finance sector reached Birr 2.28 billion as at end of December 2015. Waliya CGFC registered total assets of Birr 614 million which accounted 27% of the sector's assets, followed by OCGFC, ACGFC, KCGFC, and DCGFC with a corresponding share of 22%, 20%, 17%, and 14%, respectively. As of the same date, total capital of the sector stood at Birr 1.4 billion of which paid-up capital constituted 98%. On the other hand, the total liabilities of the sector reached Birr 0.8 billion. This mainly constitute borrowings from Commercial Bank of Ethiopia which is approximately 40% of the total credit fund (Birr 2 billion) allotted to the five leasing companies.

Table-4. Financial Position of Lease Finance companies (December 31, 2015)

	ACGFC	DCGFC	KCGFC	OCGFC	WCGFC	Total
Total Assets (in millions of Birr)	458	320	391	497	614	2,280
Total Liabilities (in millions of Birr)	5.3	122.5	192.9	274.8	211.6	807.1
Total Capital (in millions of Birr)	453.5	198.3	198.6	222.7	402.8	1,476

Source: Own compilation from reports of the leasing companies

4.2. Discussions and Analysis

4.2.1. Background Information of Respondents

Analysis of respondents profile shows that gender wise 83.3% of respondents are male and the remaining are female. On the other hand, as displayed in the table below, significant part (42.9%) of the respondents exist within the age of 36 – 45 years, while 40.5% are between 26 – 35 years and the remaining 14.3% and 2.4% are within 46 – 55 years and above 56 years, respectively (see table-5 below).

Table-5. Gender and Age of Respondents

		Frequency	Percent	Valid Percent	Cumulative Percent
Gender	Male	35	83.3	83.3	83.3
	Female	7	16.7	16.7	100.0
	Total	42	100.0	100.0	
Age	26-35	17	40.5	40.5	40.5
	36-45	18	42.9	42.9	83.3
	46-55	6	14.3	14.3	97.6
	Above 56	1	2.4	2.4	100.0
	Total	42	100.0	100.0	

Source: Survey results

As regards to educational background, 81% of the 42 respondents are first degree holders while 19% of them are having educational qualification of Master's degree and above. This figures roughly explains that the study has got an input from well educated employees of leasing companies as well as leasing stakeholders.

In terms of working experience, the greater portion (45.2%) have served in different organizations mainly in microfinance institutions within 16 – 20 years, while 28.6 percent have work experience between 6 – 10 years and the rest 14.3%, 9.5%, and 2.4% have served between 11 – 15 years, over 20 years and below 5 years, respectively (see table-6). This further indicates that the study’s reliance on well experienced employees of the lease finance sector. However, no employees of the leasing companies have prior leasing experience as confirmed by interview of selected CEOs of the leasing companies. On the other hand, respondents from the leasing experts have had strong prior experience of the leasing business in other countries before moving to Ethiopia.

Table-6. Educational Qualification, Working experience and Current position

Characteristics		Frequency	Percent	Valid Percent	Cumulative Percent
Educational Qualification	Master’s Degree and above	8	19.0	19.0	19.0
	First Degree	34	81.0	81.0	100.0
	Total	42	100.0	100.0	
Working Experience	Less than 5 years	1	2.4	2.4	2.4
	6 – 10 years	12	28.6	28.6	31.0
	11 – 15 years	6	14.3	14.3	45.2
	16 – 20 years	19	45.2	45.2	90.5
	Over 20 years	4	9.5	9.5	100.0
	Total	42	100.0	100.0	
Current Position	CEO	6	14.3	14.3	14.3
	Senior Staff	28	66.7	66.7	81.0
	Leasing Expert	3	7.1	7.1	88.1
	Supervisory Staff	5	11.9	11.9	100.0
	Total	42	100.0	100.0	

Source: Survey results

As regards to the current position of respondents, 66.7% of the respondents are senior employees of the five leasing companies, while 14.3% are CEOs in the same companies and the remaining 11.9% and 7.1% represents supervisory staff working closely on the matter (from NBE, MOT, EIC and ERCA) and leasing professionals, respectively. The above figures explain that the study obtained responses from diverse organizations working closely with the lease finance sector.

4.2.2. Legal and Regulatory Framework of Leasing

Unlike in some developing countries, 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 comprehensive 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.

One of the objectives of the amended proclamation was to demarcate between the roles of NBE and MOT in providing licenses as well as to segregate provision of Capital Goods Finance services from operating leasing services. Accordingly, the mandate of licensing and regulating capital goods finance business is given to the NBE while the mandate of regulating and licensing operating lease business is provided for the MOT. Thus, according to article 4(3) of the amended proclamation, any person licensed to engage in capital good finance business (includes financial lease and hire-purchase) may not undertake operating lease business.

In order to regulate and supervise recently established capital goods finance companies, the NBE so far has issued the following five directives:

- a) Minimum paid-up capital requirement directives No. CGFB/01/2013 that prescribes Birr 200 million as a minimum regulatory capital for new entrants. In respect of this issue, significant number of the respondents (73.8%) perceive that the minimum paid-up capital is set to be high which may be a barrier for new entrants from the private sector.

- b) Licensing requirement directives No. CGFB/02/2013. These directives require leasing companies to be established in the form of share companies in line with the provisions of Commercial Code of Ethiopia. It also put in place the minimum qualification and experience requirements for appointment of CEOs and Board of Directors.
- c) Return format directives No. CGFB/03/2016. These directives prescribe the manner of reporting formats for financial and operational information of CGFCs on a quarterly basis to the NBE.
- d) Capital adequacy ratio requirement directives No. CGFB/04/2016. The minimum capital ratio for CGFCs is set to be 10% as per these directives.
- e) Limit on capital goods finance exposure to a single lessee directives No. CGFB/05/2016. According to this directives, the maximum exposure limit to be granted to a single lessee at any point in time by the leasing companies should not exceed Birr one million. However, before issuance of this regulatory limit, the existing leasing companies were providing capital goods financing exceeding the limit as per the interview with selected CEOs of the leasing companies. Such condition may put the companies in a challenge to bring down the existing exposure to the regulatory limit.

In order to assess respondents' perception on adequacy, clarity and appropriateness of the legal and regulatory framework, nine questions were asked. The mean response of the nine questions were more than 3.00 and the standard deviation were also less than 1.00 (except for two questions), indicating that the respondents perceptions were close to one another. Though significant portion (71.4%) of the respondents have the opinion that the current legal and regulatory framework is adequate to regulate the leasing sector, almost all respondents suggested that there is still a need to revise or clarify regulations particularly in respect of the implementation of tax incentives (see table 7). This is due to the fact that the leasing sector is currently unable to benefit from the tax exemption provided in the law, though efforts are under way to resolve the issues as per the interview result.

Table-7. Descriptive Statistics of Legal and regulatory framework of Leasing

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Do you think the current legal and regulatory framework is adequate to regulate the leasing sector?	42	2	4	3.62	.661
The leasing laws and regulations has clarity	42	1	5	3.50	.862
Still there is a need to revise or clarify in respect of tax	42	4	5	4.76	.431
The current legal framework doesn't prohibit leasing companies	42	1	5	3.12	.861
Allowing foreign investors to engage in leasing business may contribute to expanding	42	2	5	4.33	.687
The current regulation on registration of capital goods and lease agreement is suitable	42	1	5	3.17	1.360
The minimum paid-up capital requirement for establishing a leasing company is set to be high for new entrants	42	1	5	3.62	1.168
Contract enforcement in leasing business particularly in the case of hire-purchase may be difficult due to the issue of co-ownership.	42	4	5	4.55	.504
Overall, the legal and regulatory environment is favorable and supportive	42	2	5	3.64	.759
Valid N (listwise)	42				

Source: Survey Result

With regard to registration and supervision of Capital Goods and lease agreement, the government has issued regulation No. 309/2014 to be implemented under the mandate of MOT. This regulation is very essential for the development of leasing sector, if implemented effectively. However, according to the interview with the officials of Addis Ababa Trade Bureau, some leasing companies have provided capital goods finance services without getting registered the capital goods and related lease agreements. This is in violation of the regulation, and may affect the legal repossession of the capital goods (at time of lessee's default) if not registered within short period of time. Because two issues are clearly mentioned in the regulation i) it is mandatory to register the capital goods as per Article 3(1), and ii) According to Article 6(5), a capital goods lease agreement concluded with enterprises or its amendments shall have no legal effect unless registered in accordance with the provisions of the regulations.

Moreover, as may be observed from table-8 below, a good number of respondents (40.5%) do not agree with the question that the current regulation on registration of capital goods and lease agreement is suitable. According to the interview result, there is some misunderstanding on how to implement or benefit from the regulation by the leasing companies. On the other hand, there is also capacity constraints from the side of MOT and respective regional bureaus in terms of number of manpower and lack of

training on the subject which is hampering the effective implementation of this regulation, as per the interview result.

Table-8 The current regulation on registration of capital goods and lease agreement is suitable

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly Disagree	5	11.9	11.9	11.9
Disagree	12	28.6	28.6	40.5
Neutral	4	9.5	9.5	50.0
Agree	13	31.0	31.0	81.0
Strongly Agree	8	19.0	19.0	100.0
Total	42	100.0	100.0	

Source: Survey results

Respondents are also asked to indicate their perception whether involvement of foreign investors will contribute to the development of leasing market if allowed to engage in leasing business. Accordingly, more than 92% of the respondents have agreed that foreign investors' involvement has many benefits for the leasing market. Similarly, the interview result with the leasing experts reveals that involvement of foreign investors will introduce transfer of leasing skills to local staff, enhanced use of technology as well as efficiency in leasing operations.

4.2.3. Ownership and Governance Structure of Lease finance companies in Ethiopia

4.2.3.1. Ownership structure

As can be observed from table-9 below, the Ethiopian leasing companies are majorly owned by regional governments and big MFIs. The total number of founding shareholders of the five leasing companies range from 8 to 11, indicating very limited shareholder base. According to the provisions of Commercial Code of Ethiopia, board of directors shall be elected from shareholders, and the chairperson shall be a natural person. One limitations in shareholding in respect of the legal issue is that in some leasing companies there is only one natural person as a shareholder which may create difficulty to change the chairperson if necessary.

Table-9. Ownership structure of Lease finance companies in Ethiopia

Name of	Regional	Big MFIs	Associations	Individuals	Total number
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CGFC	Gov't (%)	(%)	(%)	(%)	of founding shareholders
Addis CGFC	79.9	19.9	0.0044	0.0004	8
Waliya CGFC	24.9	49.9	25	0.0001	7
Oromiya CGFC	49.9	50	-	0.0005	7
Kaza CGFC	4.9	72.9	22.2	0.0001	11
Dehub CGFC	44.9	20	35	0.00001	11

Source: Author's computation from Memorandum & Articles of Association (of CGFCs)

From the table-10 below, for instance, Addis Credit and Saving Institution and Addis Ababa city administration controls more than 99% of the total shareholding in Addis leasing company. These two shareholders are not expecting financial return in the form of dividends from the leasing company, which may have its own implication on the performance and effectiveness of the management.

Table-10. Summary of Ownership Structure of Leasing Companies

Name of CGFC	Major shareholders	Remarks
Addis CGFC	AdCSI & Addis Ababa city administration	Hold 99.8% of total shareholding
Waliya CGFC	ACSI & Amhara regional state	Hold 74.9% of total shareholding
Oromiya CGFC	OCSSCO & Oromia National Regional State	Hold 95% of total shareholding
Kaza CGFC	DECSI & Tigray National Regional State	Hold 77.7% of total shareholding
Dehub CGFC	Omo MFI & SNNPR	Hold 64.9% of total shareholding

Source: Own compilation from Memorandum & Articles of Association of the companies

4.2.3.2. Governance Structure

The governance structure of the Ethiopian leasing companies is a reflection of the ownership structure. The survey results indicate that there are limitations in the governance structure that requires revision for effective management of the companies. In this regard, the respondents are asked to provide their views on the proposition that the higher governing organs are properly discharging their duties and responsibilities as

well as conduct meetings to review strategic issues of the company. However, a good number of respondents (38.1%) have shown their disagreement to the first notion and more than 50% of the respondents also disagree with the second notion to indicate that the boards of directors do not regularly meet to review the strategic issues. This explains that the boards of directors are not committing their time due to their busy schedule in other assignments in other government organizations.

In terms of qualification, the lease finance sector is governed by 34 board members having qualification at least first degree (see table-11 below). Thus, the board members have fulfilled the minimum qualification requirement of NBE directives No. CGFB/02/2013. Out of the total number of board of directors 67.6% have qualification of second degree and above, indicating that the board members are well qualified in-terms of qualification. However, there is a gap of leasing skills that needs to be addressed through provision of trainings to board members of leasing companies.

Table-11. Number and profile of board members of CGFCs (March 2016)

Name of CGFC	No. of BODs	2 nd Degree & above	1 st Degree
Addis CGFC	6	4	2
Waliya CGFC	7	6	1
Oromia CGFC	5	2	3
Kaza CGFC	7	5	2
Dehub CGFC	9	6	3

Source: Compiled by Researcher from reports of CGFCs.

From table-11 above, it can be observed that the members of board of directors of Addis and Oromia CGFCs are limited to six and five, respectively. Such limitation in number of board members would not allow formation of board sub-committees (such as audit and risk governance committee) that are helpful for discharging duties and responsibilities of the full board effectively. Actually, it's not only the number, but the right mix of qualifications and experiences of the board members are crucial for effective execution of board responsibilities.

4.2.4. Types of Products and Equipments Leased

As at December 31, 2015, Sectorial classifications of capital goods finance indicates that 99.8% (Birr 89.3 million) was provided for manufacturing sector while the remaining (0.2%) was granted for construction sector (see table-12 below). Though the majority of the capital goods finance was granted to manufacturing sector, there is diversification into different sub-sectors within the manufacturing sector such as textile, leather machinery, agro-processing, etc as per the interview result. Yet, it seems that there is high concentration of capital goods financing in a single product/equipment or sector. According to the interview with leasing experts, leasing in the industrial or manufacturing sector is the most complex type compared with other sectors.

Table-12. Distribution of Capital Goods Finance in different Sector/equipments

As of December 31, 2015 (Amount in thousands of Birr)

Companies	Agriculture	Manufacturing	Construction	Service	Others	Total
Addis CGFC	-	25,270.29	-	-	-	25,270.29
Debut CGFC	-	326	-	-	-	326.00
Kaza CGFC	-	-	-	-	-	-
Oromia CGFC	-	47,487.01	154.99	-	-	47,642.00
Waliya CGFC	-	16,291.82	-	-	-	16,291.82
Total		89,375.12	154.99	-	-	89,530.11

Source: Own compilation from reports of leasing companies

4.2.5. Supply Chain Systems

In order to ensure efficient leasing transactions, a supplier-lessor relationship is very crucial. However, in Ethiopia, this is yet to come. In connection with the issue of supply chain systems, respondents were asked seven questions (see table-13 below). These questions focuses on the number of suppliers, quality and price of equipments supplied, reliability and dependability of suppliers, and whether there exist poor supply-linkage between the lessors and manufacture/supplier. Hence, all questions were answered with a mean response of more than 3.00 and standard deviation of less than 1.00. This reveals that respondents have an agreement with a closer perception to one another.

Table-13 Descriptive Statistics of Supply chain systems

	N	Minimum	Maximum	Mean	Std. Deviation
Currently, there are limited number of domestic equipment suppliers in the market.	42	4	5	4.88	.328
The type, quality and pricing of equipments being supplied currently is not up to the expectation of the lessee and lessor	42	4	5	4.86	.354
The existing suppliers in the market are not dependable and reliable.	41	3	5	4.24	.624
Suppliers have limited or no awareness about leasing.	42	4	5	4.52	.505
The benefit of leasing in increasing sales volume is not well understood by the equipment suppliers	42	4	5	4.43	.501
There is weak supply-linkage between manufacturers/suppliers and lessors	42	4	5	4.67	.477
Improved supply chain system encourages leasing sector development	41	4	5	4.68	.471
Valid N (listwise)	41				

Source: survey results

4.2.6. Prospects and opportunities of the leasing sector

Under the GTP-II program, the governments of Ethiopia's key priority industries include: textile and garment industry, leather and leather products, sugar and sugar-related products, metal and engineering, and agro-processing. All this priority industries need capital equipments or machineries and have its own potential to enhance the leasing market. In relation to prospects and opportunities of the leasing sector, nine questions were presented to respondents. Thus, all questions had a mean response of more than 3.00 and standard deviation of less than 1.00 (see table-14 below), depicting that respondents' perception is closer to one another.

Table-14 Descriptive Statistics of Leasing Prospects

	N	Minimum	Maximum	Mean	Std. Deviation
Leasing has high market potential for growth in Ethiopia.	42	2	5	4.69	.604
Lease financing services of CGFCs enhance SMEs development in the country	42	4	5	4.62	.492
Leasing as an alternative finance for SMEs in Ethiopia will unlock the limited access to finance	42	4	5	4.50	.506
Leasing also mitigates market weaknesses of SME lending	42	4	5	4.36	.485
The manufacturing sector & construction sectors, as an emerging sector, would be vital to the growth and development of the leasing sector.	42	2	5	4.38	.661
The government's current policy encourages the development of leasing sector.	42	3	5	4.43	.590
Sustained and fast economic growth of the country contributes to growth potential of leasing sector	42	4	5	4.60	.497
Involvement of foreign investors in leasing business could develop the sector in general	42	2	5	4.14	.683
Overall, the governments support plays an important role in the growth and development of leasing sector in the country.	42	4	5	4.48	.505
Valid N (list-wise)	42				

Source: Survey results

For instance, as regards to leasing potential for growth in Ethiopia, 97.6% of respondents have answered that it has high market potential (see table-15 below). In addition, the interview result shows the same as explained below.

Table-15 Leasing potential for growth

Leasing has high market potential for growth in Ethiopia.

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Disagree	1	2.4	2.4	2.4
Agree	10	23.8	23.8	26.2
Strongly Agree	31	73.8	73.8	100.0
Total	42	100.0	100.0	

Source: Survey results

According to the interview result with the leasing experts, Ethiopia currently imports over USD 1.7 billion worth of capital goods per annum on average and if we take the average opportunity to be 15%, leasing growth potential could easily be estimated to

USD 255 million per annum. This estimation of leasing potential is in line with the IFC (2008)'s method of computing the leasing market potential for developing countries as a share of capital goods imports that ranges between 10 – 20%. For example, in a developing country with low levels and sophistication in leasing like Ghana, IFC estimated 15% of capital goods imports in Ghana as leasing potential (IFC, 2008).

Moreover, as may be observed from the table-16 below, 100 percent of the respondents have shown their agreement on the question that whether the leasing services of capital goods finance companies enhance the SMEs development in Ethiopia. Thus, the provision of lease financing services contributes to the development of SMEs in the country which in-turn stimulates the economic growth as well as creates additional job opportunities. Further, as per the interview result with the leasing experts, the government's economic development strategy has SMEs playing a critical role, as part of GTP II. Thus, leasing could and will be the preferred financing solution to these entities. With that leasing will grow rapidly. This movements coupled with the tax incentives provided by the government to leasing business (if implemented effectively) could help grow the leasing sector over the next years.

Table-16 Contribution of Leasing services to SMEs development

Lease financing services of CGFCs enhance SMEs development in the country					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Agree	16	38.1	38.1	38.1
	Strongly Agree	26	61.9	61.9	100.0
	Total	42	100.0	100.0	

Source: Survey results

4.2.7. Leasing Awareness

The level of leasing awareness of SMEs and the public is assessed based on the response obtained from the supply side particularly from the leasing companies and leasing stakeholders. In this regard, three questions were requested to solicit respondents' perception on their assessment of leasing awareness of SMEs and the public with regard to its nature and benefits. Accordingly, all questions had a mean response of more than

3.00 and standard deviation of (by far) less than 1.00 (see table- below), explaining that respondents have shown their agreement in manner that is closer to one another. Thus, it can be argued that both SMEs and the general public lack awareness on the nature and benefits of leasing. In addition, suppliers have also limited or low level of leasing awareness as evidenced by the survey results (see table below).

Table-17 Descriptive Statistics of Leasing Awareness

	N	Minimum	Maximum	Mean	Std. Deviation
Both SMEs and the general public lack awareness on the nature and benefits of leasing.	42	3	5	4.24	.617
There is also limited or non-existent leasing awareness of suppliers.	42	3	5	4.40	.544
All leasing players or stakeholders need to collaborate to enhance leasing awareness of SMEs & the public at large.	42	4	5	4.81	.397
Valid N (list-wise)	42				

Hence, as can be seen from the table-17 above, respondents have provided their strong suggestion that all leasing players or stakeholders need to work together to enhance leasing awareness for development of same.

4.2.8. Challenges of Lease Finance Sector in Ethiopia

There were eleven questions introduced to respondents in respect of challenges of lease finance sector. All questions have been fully answered by respondents. As can be seen from the table below, all questions had a mean response of more than 3.00 and standard deviation of less than 1.00, except one question. This indicates that the respondents perception were very closer to one another. The result in table below revealed that respondents have agreed up on the challenges of lease finance sector.

Major challenges identified by the respondents or challenges that the respondents have shown their full agreement 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. Thus, out of eleven challenges introduced in the questionnaire, all respondents have shown strong agreement on the abovementioned six challenges and also shown their agreement with the remaining challenges at varying degree. This result is similar with other studies conducted in India (Brahmaiah,1992) and Zambia (Aloysius & Lubinda, 2013).

As observed in many other studies, respondents have identified (with a mean response of 4.55) funding problem as a major challenge for the leasing companies. According to the interview result this is due to the fact that the leasing companies in Ethiopia are non-deposit taking institutions. In other countries like Sri-Lanka, specialized leasing companies are also non-deposit taking financial institutions. Due to this reality, leasing companies are being challenged to easily source funds for their investments in lease financing businesses.

The survey respondents strongly agreed (with a mean response of 4.76) on existence of unclear interpretation of tax incentives provided by law. Due to this challenge, the tax incentives given to the leasing business as exemption of customs duty on importation of equipments as well as VAT exemption in the amended Capital Goods leasing proclamation No. 807/2013 has not yet been implemented. According to the interview result, most leasing companies had processed their leasing transactions without utilizing the duty free privilege provided by law, until end of February 2016. The interviewees have also indicated that ERCA prohibited the duty free privilege until the issues are resolved among concerned government organs such as Ethiopian Investment Commission. To this end, currently the concerned leasing stakeholders are working together to find solution in respect of the tax issues as mentioned during the interview with key stakeholders. According to Ahmed et al. (2003), tax related issues are mentioned as one of the major factor affecting the overall performance of the leasing sector in Pakistan.

The other challenge experienced by the leasing companies was the lack of skilled staff and leasing expertise in the market. Large number of respondents (71.4%) shown their strong agreement on existence of no or inadequate prior leasing expertise in the market.

According to the interview result, there is no training institution in Ethiopia offering specialized leasing training. Thus, except few on-the-job training exposures and some limited experience in other financial institutions such as micro-finance, the existing employees of the five leasing companies do not have prior leasing experience as confirmed by the survey respondents. This contributes to limited technical capacity of the staff to competently and sufficiently structure lease-financing transactions and manage the lease portfolio properly. According to Aloysius & Lubinda (2013), leasing needed specialized employee skills that could equip them competently structure a lease transaction. However, the five leasing companies commenced operation by obtaining few exposure visits to selected countries and some short term lease finance trainings provided by IFC in collaboration with NBE, as per the information from the regulatory body. Moreover, the supervisory staff of the NBE does not have previous experience of supervising and regulating lease finance companies since these companies are established in 2014, after enactment of the amended capital goods leasing business proclamation No. 807/2013.

Existence of poor supply chain linkages as well as procurement hurdles in the country was also identified as a major challenge by the survey respondents (with a mean response of 4.57). According to the interview result, it was difficult to find adequate and/or reliable domestic suppliers for particular specialized equipment. Not only the number of suppliers, but also the types of available equipments are very limited compared to the machinery and equipment needs of SMEs in the country.

Lack of clear regulation about involvement of foreign investors in leasing business is also the other challenge. Respondents (64.3%) have agreed on this issue (with relatively lower mean response of 3.76). Although, recently issued capital goods leasing business (amendment) proclamation No. 807/2013 doesn't have provisions to prohibit foreign investors (unlike other proclamations of financial institutions being implemented under the mandate of NBE), the investment regulation No. 270/2012 reserves leasing business to domestic investors only. According to the leasing experts interviewed for this study, there is a need to harmonize the differences between the two laws so as to allow potential foreign investors currently showing their interests to engage in leasing

businesses in Ethiopia. If foreign investors are allowed to invest in leasing business in this regard, this could be a new phenomenon in the Ethiopian financial sector.

Table-18. Descriptive statistics of Challenges of Lease Finance Sector in Ethiopia

Descriptive Statistics					
List of Challenges	N	Minimum	Maximum	Mean	Std. Deviation
Lack of availability of low cost and long-term funding	42	4	5	4.55	.504
Unclear interpretation of tax issues or inability to utilize tax incentives provided by the law.	42	4	5	4.76	.431
Existence of inadequate supply chain linkages as well as procurement hurdles	42	4	5	4.57	.501
Difficulty in contract enforcement or challenges in repossession may affect the growth of leasing business	42	1	5	4.05	.909
There is limited domestic supplier as well as lack of reliable supplier	42	4	5	4.50	.506
Lack of adequate leasing expertise in the market	42	4	5	4.71	.457
Absence of specialized leasing training center or resident leasing trainers in the country	42	4	5	4.67	.477
Difficulty in asset management due to absence of secondary market for disposing repossessed leased equipments.	42	3	5	4.05	.731
Lack of clear regulation about involvement of foreign investors	42	1	5	3.76	1.031
Lack of specialized leasing software (MIS)	42	3	5	4.52	.634
Absence of asset/equipment valuers in the market	42	2	5	4.31	.749
Valid N (listwise)	42				

Source: Survey Result

The remaining challenges that affects the leasing sector include: lack of non-court repossession or easy contract enforcement mechanisms in case the lessee defaults; non-existence of secondary market for disposing repossessed leased equipments; lack of specialized leasing software (MIS) and absence of asset or equipment valuers in the market.

CHAPTER – FIVE

5. CONCLUSIONS AND RECOMMENDATIONS

This final chapter presents the conclusions and recommendations based on the study findings and analysis. The study attempted to look into the current performance of lease finance sector, ownership and governance structure, legal and regulatory framework of leasing, types of products and equipments leased, and the existing supply chain systems. Moreover, the study has also tried to collect views and opinions of the lease finance stakeholders on the level of leasing awareness and challenges of the sector which have been analyzed subsequently. Thus, on the basis of analysis of the primary and secondary data, the following conclusions and recommendations are forwarded.

5.1. CONCLUSIONS

In Ethiopia, lease financing is at its infant stage of development. Although the leasing 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.

- Although Ethiopia has a leasing industry specific legislation, there are a number of laws affecting the leasing business. In some cases, there are some contradictions in the law that needs to be harmonized. Although, the recently issued capital goods leasing business (amendment) proclamation No. 807/2013 doesn't have provisions to prohibit foreign investors (unlike other proclamations of financial institutions being implemented under the supervision of NBE), the investment regulation No. 270/2012 reserves leasing business to domestic investors only. Thus, so far no foreign owned leasing company has been set-up, despite some green lights from the side of government as per the interview result. With regard to issues of repossession (in case of default), the legal framework should permit non-court repossession, so that lessors can repossess leased assets without going to court as long as the lessee does not contest the repossession (IFC,2009). However, in Ethiopia, so far there is no mechanism of easy repossession of

leased asset (particularly for hire-purchase product) without judicial process. Moreover, dispute resolution mechanisms are yet to be implemented.

- The Ethiopian leasing companies are majorly owned by regional governments and big MFIs. The total number of founding shareholders of the five leasing companies range from 8 to 11, indicating very limited shareholder base. The governance structure of the Ethiopian leasing companies is a reflection of the ownership structure. The survey results indicate that there are limitations in the governance structure that requires revision for effective management of the companies. Since most of the board members are busy with other assignments in other government organizations, adequate attention was not given to conduct meetings on a regular basis with a focus of strategic issues of the company.
- The leasing portfolio of the Ethiopian leasing sector is highly dominated by the financing of manufacturing equipments, despite the complex nature of such equipments in managing leasing risks coupled with low level of leasing skills. Though there is diversification into different sub-sectors within the manufacturing sector such as textile, leather, and agro-processing machineries, still it seems that there is high concentration of capital goods financing in a single product/equipment or sector.
- Leasing has high market potential for growth in Ethiopia. This is evidenced by both the survey analysis and interview result. For instance, as regards to leasing potential for growth in Ethiopia, 97.6% of respondents have answered that it has high market potential. Moreover, according to the interview result with the leasing experts, Ethiopia currently imports over USD 1.7 billion worth of capital goods per annum on average and if we take the average opportunity to be 15%, leasing growth potential could easily be estimated to USD 255 million per annum. This estimation of leasing potential is in line with the IFC (2008)'s method of computing the leasing market potential for developing countries as a share of capital goods imports that ranges between 10 – 20%. For example, in a developing country with low levels and

sophistication in leasing like Ghana, IFC estimated 15% of capital goods imports in Ghana as leasing potential (IFC, 2008).

- 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. As part of GTP II, the government economic development strategy has SMEs playing a critical role. Thus, leasing could and will be the preferred financing solution to these entities. However, the current leasing awareness in Ethiopia is at its low level and need to be enhanced with the concerted efforts of key leasing stakeholders.

- The study identified that 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. Thus, out of eleven challenges introduced in the questionnaire, all respondents have shown strong agreement on the abovementioned six challenges and also shown their agreement with the remaining challenges at varying degree. This result is similar with other studies conducted in India (Brahmaiah,1992) and Zambia (Aloysius & Lubinda, 2013). The remaining challenges that affects the leasing sector include: lack of non-court repossession or easy contract enforcement mechanisms in case the lessee defaults; non-existence of secondary market for disposing repossessed leased equipments; lack of specialized leasing software (MIS) and absence of asset or equipment valuers in the market.

5.2. RECOMMENDATIONS

Though similar empirical studies are expected to be carried out in near future due to the newness of leasing sector in Ethiopia, this study forwarded the following recommendations based on the findings and analysis done. The recommendations are classified into two for the short-run/medium term and long-run:

In the Short-run/Medium term:

- **In order to create enabling regulatory environment for leasing, development of complete regulatory and supervisory policy is expected from NBE.** Moreover, the MOT should develop effective and efficient registration system of capital goods and leasing contracts as well as work on enforcement of contracts to enhance development of leasing sector. Improvement of legislative framework for leasing should clarify rights and responsibilities of the parties to a lease; remove contradictions within the existing legislation; create non-judicial repossession mechanisms; ensure that tax regulations are clear; as well as clarify the rights of lessors and lessees in case of default. Furthermore, the minimum paid-up capital requirement to set-up a new leasing company should be revised in order to minimize barriers for new entrants particularly from the private sector.
- **There is a need to strengthen the capacities of leasing companies, regulatory authorities, as well as leasing stakeholders.** To this end, the employees of key stakeholders including leasing companies and regulators (both NBE & MOT) should be exposed to international leasing experiences and best practices through designing knowledge exchange visits to selected countries. In addition, short-term trainings should be provided in the areas of lease structuring and pricing, management of leasing risks, lease portfolio management, lease accounting and taxation treatment.
- **All leasing companies has the responsibility to register the capital goods and the related lease agreements** at concerned government organ in accordance with regulation No. 309/2014, otherwise, the leasing agreements concluded with enterprises shall have no legal effect.
- **The government should facilitate funding to specialized leasing companies from commercial banks through provision of guarantees, due to non-deposit**

taking nature of the companies. Like in many other developing countries, funding could be a critical challenge for the development of leasing sector in Ethiopia.

- **All leasing stakeholders should work together to raise the leasing awareness of the public as well as SMEs,** in a manner that spur the development of the sector. The government's support in this regard plays an important role on the development of leasing sector in particular and economic growth in general.

In the Long-term:

- **The leasing companies should be allowed to mobilize term deposits from companies as well as the general public by setting the minimum time period in order to create sustainable funding.** In this regard, IFC (1996) suggested that leasing companies should be allowed to mobilize term deposits, but not demand savings in such a way that their liquidity be matched. In addition, allowing the leasing companies to issue debentures and/or access foreign borrowings as a special privilege that could help minimize the funding challenges. In Sri-Lanka, leasing companies or licensed finance companies are authorized by the central bank to mobile funds from the general public through deposits and issuance of debentures.
- **Specialized leasing training center should be established** to enhance the capacity of leasing players in the market and to give trainings of trainers. This is due to the fact that leasing requires specialized skills unlike other financial products.
- **Establishment of national leasing association should be sought** for lobbying leasing legislative reforms & enhance capacity of lessors through well-organized and tailored trainings.
- **Lease finance companies should be allowed to take advantage of the Credit Reference Bureau (CRB) not to lease-out to defaulted lessees** and for proper management of credit risks. It is recommended that NBE creates comprehensive credit reference bureau that enhances credit information sharing between all lease finance companies and other financial institutions including banks.

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Appendix (A)



Addis Ababa University
Department of Accounting & Finance
Master's Program: MSc in Accounting & Finance

Research Questionnaire

Name of Researcher: Asfaw Abera (MSc Student)

E-Mail: asfawabera@gmail.com

Dear Sir/Madam,

This questionnaire is designed to conduct academic research on “Lease Financing in Ethiopia: An assessment of the five licensed lease finance companies” as part of the fulfillment of Master’s Degree in Accounting and Finance at Addis Ababa University. The main objective of the study is to conduct diagnostic assessment of the potential prospects, opportunities and challenges facing the leasing industry in Ethiopia including assessment of legal and regulatory framework. It also aims to contribute towards improving the gap in local publications on leasing phenomenon in the country.

The data you provide in response to the questionnaires will be only used for academic purpose in accomplishment of the said study. Thus, respondents are encouraged to provide their opinions objectively, independently and free from any bias. Your responses are strictly kept confidential and they are used exclusively for this research. Your input is highly valuable for completion of this study. To indicate your choices, please put “X” mark on your selected choice. The completed questionnaire is expected to be collected latest by February 08, 2016.

Should you have any enquiries or clarifications, kindly please contact me in person through my e-mail: asfawabera@gmail.com or give me a call at 0911-86-56-98.

Thank you very much for your valuable time and cooperation in the data supply.

Yours Sincerely,

Asfaw Abera

Asfaw Abera

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 questions 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:

- a) 1= SD = Strongly Disagree
- b) 2= D = Disagree
- c) 3= N = Neutral
- d) 4= A = Agree
- e) 5= SA = Strongly Agree

Section II: Lease financing in Ethiopia: Legal and Regulatory Framework

No.	Please indicate the extent of your agreement on the following statements in relation to legal and regulatory framework of leasing:	SD (1)	D (2)	N (3)	A (4)	SA (5)
6.	The current legal and regulatory framework is adequate to regulate the leasing sector.					
7.	The leasing laws and regulations has clarity in defining the lease contract, leased assets, responsibilities and rights of parties to a lease contract.					
8	Still there is a need to revise or clarify the provisions in the law in respect of tax incentives to remove tax barriers to leasing for effective implementation.					
9	The current legal framework doesn't prohibit leasing companies to be part of the Credit Reference Bureau and use the services.					
10	Allowing foreign investors to engage in leasing business may contribute to expanding the leasing market and enhance public awareness.					
11	The current regulation on registration of capital goods and lease agreement is suitable for development of leasing and encourages establishment of well functioning asset registry.					
12	The minimum paid-up capital requirement for establishing a leasing company is set to be high for new entrants.					
13	Contract enforcement in leasing business particularly in the case of hire-purchase may be difficult due to the issue of co-ownership.					
14	Overall, the legal and regulatory environment is favorable and supportive.					

Section III: Ownership and Governance structure of lease finance companies in Ethiopia

No.	Please indicate the extent of your agreement on the following statements in respect of ownership and governance of lease finance companies in Ethiopia.	SD (1)	D (2)	N (3)	A (4)	SA (5)
15	The higher governing organs are properly discharging their duties and responsibilities.					
16	Board of directors conduct meetings on a regular basis to review strategic issues of the company.					
17	Senior management members meets regularly.					
18	There are some limitations in the current ownership and governance structure of the company, which may compromise proper governance of the company, e.g. timely & effective decision making, etc.					
19	Most of the board of directors are not able to attend meetings due to various assignments in other organization.					
20	The current ownership and governance structure does not allow to maintain a proper mix of experience and qualification in the Board due to limited number of shareholders.					
21	The current ownership and governance structure may affect size of the board, formation of sub-committees, board oversight, and effectiveness of decision making.					
22	It is possible to form sub-committees in the board.					
23	Existence of limited number of BODs restricts formation of subcommittees.					
24	BODs & Management have adequate leasing experience to lead and monitor the company.					
25	There is proper relationship and communication					

	between the BODs and management.					
26	Absence of real financial stake in the company restricts the commitment of board of directors.					
27	Participation of foreign or private investors in the leasing business could promote efficient services, help diffuse best practices and contribute to development of innovative leasing products.					
28	The current ownership and governance structure needs to be revised for effective decision making and better contribute to growth & sustainability of the company.					

Section IV. Types of products & equipments leased

No.	Please indicate the extent of your agreement on the following statements in connection with types of products	SD (1)	D (2)	N (3)	A (4)	SA (5)
29	The company provides both financial lease and hire-purchase products.					
30	There is limited number and type of products allowed by the law.					
31	Sector wise, the company mainly focuses on the financing of the manufacturing equipments.					
32	Involvement of foreign investors in leasing business helps to improve leasing expertise & develop innovative products.					
33	Changes in legal and regulatory framework is needed to allow leasing companies to provide other products.					

Section V. Supply chain systems

No.	Please indicate the extent of your agreement on the following statements in relation to supply chain systems.	SD (1)	D (2)	N (3)	A (4)	SA (5)

34	Currently, there are limited number of domestic equipment suppliers in the market.					
35	The type, quality and pricing of equipments being supplied currently is not up to the expectation of the lessee and lessor.					
36	The existing suppliers in the market are not dependable and reliable.					
37	Suppliers have limited or no awareness about leasing.					
38	The benefit of leasing in increasing sales volume is not well understood by the equipment suppliers.					
39	There is weak supply-linkage between manufacturers/suppliers and lessors.					
40	Improved supply chain system encourages leasing sector development					

Section V. Prospects of the leasing sector

No.	Please indicate the extent of your agreement on the following statements in connection with prospects of the leasing sector in Ethiopia.	SD (1)	D (2)	N (3)	A (4)	SA (5)
41	Leasing has high market potential for growth in Ethiopia.					
42	Lease financing services of CGFCs enhance SMEs development in the country					
43	Leasing as an alternative finance for SMEs in Ethiopia will unlock the limited access to finance.					
44	Leasing also mitigates market weaknesses of SME lending					
45	The manufacturing sector & construction sectors, as an emerging sector, would be vital to the growth and development of the leasing sector.					
46	The government's current policy encourages the development of leasing sector.					

47	Sustained and fast economic growth of the country contributes to growth potential of leasing sector					
48	Involvement of foreign investors in leasing business could develop the sector in general					
49	Overall, the governments support plays an important role in the growth and development of leasing sector in the country.					

Section VI. Leasing awareness (nature & benefits of leasing);

No.	Please indicate the extent of your agreement on the following statements.	SD (1)	D (2)	N (3)	A (4)	SA (5)
50	Both SMEs and the general public lack awareness on the nature and benefits of leasing.					
51	There is also limited or non-existent leasing awareness of suppliers					
52	All leasing players or stakeholders need to collaborate to enhance leasing awareness of SMEs & the public at large.					

Section VI. Challenges of the lease finance sector:

No.	Please indicate to what extent the following factor affect the leasing sector.	SD (1)	D (2)	N (3)	A (4)	SA (5)
53	Lack of availability of low cost and long-term funding					
54	Unclear interpretation of tax issues or inability to utilize tax incentives provided by the law.					
55	Existence of inadequate supply chain linkages as well as procurement hurdles					
56	Difficulty in contract enforcement or challenges in repossession may affect the growth of leasing business					
57	There is limited domestic supplier as well as lack of					

	reliable supplier					
58	Lack of adequate leasing expertise in the market					
59	Absence of specialized leasing training center or resident leasing trainers in the country.					
60	Difficulty in asset management due to absence of secondary market for disposing repossessed leased equipments.					
61	Lack of clear regulation about involvement of foreign investors					
62	Lack of specialized leasing software (MIS)					
63	Absence of asset valuers in the market					

Section VII: General Comments

7.1. In your opinion, what are the major challenges encountered by lease financing companies in Ethiopia?

7.2. How do you express your perception towards the growth potential and prospects of the leasing sector in Ethiopia?

7.3 What recommendations do you provide to address the abovementioned challenges and promote the development of leasing sector in Ethiopia?

I cordially appreciate your time and cooperation!

Thank you very much!

Appendix (B)

An Interview Guide

Name of Researcher: Asfaw Abera (MSc Student)
Addis Ababa University
Department of Accounting and Finance
E-Mail: asfawabera@gmail.com

Dear Sir/Madam,

The main objective of this interview is to explore information regarding lease financing practice in Ethiopia and to have an in-depth response to the research problem in addition to the questionnaires distributed to various leasing stakeholders. The interview will be made with selected leasing experts, CEOs of leasing companies, officials of MOT and EIC 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 on “Lease Financing in Ethiopia: An assessment of the five regulated lease financing companies”.

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.

Kind regards,

Asfaw Abera

Asfaw Abera

INTERVIEW QUESTIONS FOR LEASING EXPERTS AND CEOs OF CGFCs:

- a) Are the current leasing laws and regulations have clarity and adequacy to regulate the leasing sector?
- b) Is the current minimum paid-up capital requirement for establishing a leasing company being considered to be high?
- c) Is the current ownership and governance structure of leasing companies in the country contributes for the development and promotion of the leasing business?
- d) What is the current level of leasing awareness of the public?
- e) What are the prospects and market potential of leasing in Ethiopia?
- f) What are the main challenges of the lease finance sector in Ethiopia?
- g) What actions do you recommend to address the above-mentioned challenges?

INTERVIEW QUESTIONS FOR EIC:

- a) What is the rationale behind allowing foreign investors to engage in leasing business in Ethiopia?
- b) Which investment regulation currently prohibits foreign investors to engage in leasing business?
- c) When do you think the current restriction on foreign investors be lifted to allow them to engage in leasing business?
- d) What are the main requirements set by EIC to be followed by foreign investors to engage in leasing business?
- e) What are the major challenges and the way forward as regards to involvement of foreign investors in leasing business?

INTERVIEW QUESTIONS FOR MOT:

- a) What are the main issues considered to register capital goods and lease agreements?
- b) What are the current regulations applicable to registrations and supervision of capital goods and lease agreements?
- c) Are all leasing companies are registering capital goods and lease agreements as per the requirement?
- d) What are the current challenges observed in registering and supervising capital goods and lease agreements?
- e) What actions need to be undertaken to rectify challenges identified above?

Appendix (C)

Frequency Distribution Analysis Demographic Characteristics of Respondents

No.	Demographic Elements	Characteristics	Number of Respondents	Percentage
1	Gender	Male	35	83.3
		Female	7	16.7
2	Age	26 – 35	17	40.5
		36 – 45	18	42.9
		46 – 55	6	14.3
		Above 56	1	2.4
3	Educational Qualification	Master's degree & above	8	19.0
		First degree	34	81.0
		Diploma	0	-
		TVET	0	-
4	Working Experience	Less than 5 years	1	2.4
		6 – 10 years	12	28.6
		11 – 15 years	6	14.3
		16 – 20 years	19	45.2
		Over 20 years	4	9.5
5	Current Position	CEO	6	14.3
		Senior staff	28	66.7
		Leasing Expert	3	7.1
		Supervisory staff	5	11.9

Source: Survey results

Appendix (D)

Leasing as an alternative finance for SMEs in Ethiopia will unlock the limited access to finance

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Agree	21	50.0	50.0	50.0
Strongly Agree	21	50.0	50.0	100.0
Total	42	100.0	100.0	

Appendix (E)

Leasing also mitigates market weaknesses of SME lending

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Agree	27	64.3	64.3	64.3
Strongly Agree	15	35.7	35.7	100.0
Total	42	100.0	100.0	

Appendix (F)

The manufacturing sector & construction sectors, as an emerging sector, would be vital to the growth and development of the leasing sector.

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Disagree	1	2.4	2.4	2.4
Neutral	1	2.4	2.4	4.8
Agree	21	50.0	50.0	54.8
Strongly Agree	19	45.2	45.2	100.0
Total	42	100.0	100.0	

Appendix (G)

Does the government's current policy encourages the development of leasing sector?

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Neutral	2	4.8	4.8	4.8
Agree	20	47.6	47.6	52.4
Strongly Agree	20	47.6	47.6	100.0
Total	42	100.0	100.0	

Appendix (H)

Sustained and fast economic growth of the country contributes to growth potential of leasing sector

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Agree	17	40.5	40.5	40.5
Strongly Agree	25	59.5	59.5	100.0
Total	42	100.0	100.0	

Appendix (I)

Involvement of foreign investors in leasing business could develop the sector in general.

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Disagree	2	4.8	4.8	4.8
Neutral	1	2.4	2.4	7.1
Agree	28	66.7	66.7	73.8
Strongly Agree	11	26.2	26.2	100.0
Total	42	100.0	100.0	

Appendix (J)

Overall, the government support plays an important role in the growth and development of leasing sector in the country.

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Agree	22	52.4	52.4	52.4
Strongly Agree	20	47.6	47.6	100.0
Total	42	100.0	100.0	