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IMPACT OF LEASE FINANCING ON THE PROFITABILITY OF QUOTED CONSUMER GOODS COMPANIES IN NIGERIA

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Abstract

This research aims to investigate the influence of lease financing on the profitability of quoted consumer goods companies in Nigeria, with a focus on both operating and finance leases. The specific objectives of the study were to examine the impact of operating leases and finance leases on the Returns on Assets (ROA) of the selected consumer goods companies. The study adopts an ex-post-facto research design, encompassing all 20 consumer goods companies listed on the Nigerian Stock Exchange. After a meticulous manual inspection of financial statements, seven companies were selected for sample inclusion, utilizing a purposive sampling design. Data for the analysis were sourced from published yearly reports and financial statements spanning a decade (2011-2021). The statistical software EViews 10 was employed for data analysis. The findings of the study indicate a significant effect of operating leases on the Returns on Assets (ROA) and a corresponding significant effect of finance leases on the Returns on Assets (ROA) of the consumer goods companies in Nigeria. These results underscore the relevance of lease financing options in shaping the financial performance of the consumer goods sector. In light of the study's outcomes, the research offers practical recommendations. It suggests that companies in the consumer goods sector should consider adopting operating leases as a viable method for financing their operations. This is particularly emphasized due to the observed positive impact on operating profits. Unlike traditional financing methods, operating leases are highlighted as advantageous since they do not utilize or deplete the existing working capital of firms. This research contributes to the existing body of knowledge by providing empirical evidence on the impact of lease financing on the profitability of consumer goods companies in Nigeria. The insights gained from this study can guide both practitioners and policymakers in making informed decisions regarding financial strategies in the consumer goods sector. Further research avenues may explore the nuanced dynamics of lease financing in different industries or delve into the long-term implications of adopting lease financing strategies on overall corporate financial health.

Keywords: Consumer, Finance, Leasing, Organization, and Profitability.

1.0 Introduction

Leasing serves as a crucial and widely adopted financing method, offering diverse economic advantages. It allows entities ranging from startups and multinationals to public institutions to access assets like equipment, machinery, and plants without the immediate burden of outright purchase. According to the International Accounting Standard (IAS) 17, a lease is a contractual arrangement between an owner (lessor) and another party (lessee), granting the lessee the right to use the leased asset for a consideration, typically in the form of periodic payments known as rents (Ndu, 2014).

Periodic rents constitute income for the lessor, while the lessee treats them as expenses or debt obligations. Leasing, as an alternative financing avenue for plants, equipment, and property, involves a contract between the equipment owner and another party, allowing possession and use in exchange for specific rentals over a predetermined period (Bello &Almustapha, 2016). The lessee may or may not have the option to acquire property ownership at the end of the lease term.The accounting literature broadly categorizes leases into two types: operating leases and finance leases. An operating lease permits asset use without transferring ownership rights, while a finance lease allows asset use and transfers ownership upon completing the lease period, provided all other contractual obligations are met (Clark, 2018).

Access to finance remains a critical factor for corporate firms, and leasing is considered a viable financing option in both emerging and developed financial markets. Arguments supporting the significant impact of leasing on a firm's financial performance, compared to asset purchase, include tax differential effects, debt substitutability, agency costs, and free cash flows (Kurfi, 2013). In the pecking order theory of capital structure, leasing holds the first priority in external financing, making it imperative to study its effects.

Profitability, the achievement of financial targets and goals, is a fundamental aspect of a company's performance. It is measured by assessing the extent to which financial objectives are met. Profitability is crucial in evaluating the overall financial health of a business, as described by Van'Horne (2015) and Pandey (2000). Financial statement analysis and financial ratios analysis, including returns on assets (ROA), returns on equity (ROE), returns on capital employed (ROCE), operating profit margins (OPM), and earnings per share (EPS), are commonly used to evaluate profitability (Muumbi, 2014).

Previous lease accounting research has explored whether investors and managers comprehend the economic implications of the two lease categories on firm profitability (Imhoff et al., 2014). However, this research has yet to provide empirical evidence on the profitability implications of leasing. This study aims to bridge this gap by examining the practices of operating and finance leases in relation to the returns on assets of consumer goods companies in Nigeria.

1.1 Statement of the problem

The rationale behind opting for leasing as a financing method stems from its ability to offer tailored financing solutions for assets and equipment, often characterized by unique cash flows and tax features. In Nigeria, firms grapple with significant challenges in financing essential assets and equipment. Leasing has emerged as a longstanding practice to overcome these challenges, providing a relatively straightforward means of financing business activities. This approach has proven particularly beneficial for both existing financial institutions facing distress and new entities struggling to secure loans for asset or equipment acquisition. Despite the prevalent use of leasing in the current economic landscape of Nigeria, there exists a noticeable gap in in-depth empirical investigations into leasing as a source of financing, particularly in developing and emerging markets like Nigeria. While numerous studies have explored this topic in developed markets, such as those conducted by Robicheaux et al. (2018), the results are varied and not easily generalized to the Nigerian context. Furthermore, limited attention has been given to developing markets like Nigeria, and the existing research is characterized by inconsistent findings. Recognizing this gap in the literature, Muumbi (2014) identified a significant positive correlation between lease financing and Returns on Assets (ROA). Conversely, Kibuu (2015) established an insignificant positive relationship between lease financing and ROA. In light of these divergent findings, it becomes imperative for researchers to undertake a comprehensive evaluation of the relationship between lease financing options and a firm's profitability. This study aims to address this gap and contribute to a better understanding of the dynamics between lease financing and firm performance, especially in the unique economic conditions prevalent in Nigeria.

1.2 Objectives of the study

The following specific objectives were established:

1.To examine the effect of operating leases on the Returns on assets (ROA) of quoted consumer goods companies in Nigeria

2.To investigate the effect of finance leases on the Returns on assets (ROA) of quoted consumer goods companies in Nigeria.

1.3 Research Questions

The following questions were answered in the study:

1. To what extent does operating lease affect the ROA of quoted consumer goods companies in Nigeria?

2. To what extent does finance lease affect the ROA of consumer goods companies in Nigeria?

1.4 Research Hypothesis

The following hypotheses were stated in the null:

Ho1: Operating leases has no significant effect on the Returns on assets of quoted consumer goods companies in Nigeria

Ho2: Finance leases has no significant effect on the Returns on assets of quoted consumer goods companies in Nigeria.

2.0 Review of related literature

2.1Conceptual Review

Lease Financing: A Comprehensive Historical Perspective

Lease financing has undergone a transformative journey, evolving from principles-based to rules-based pronouncements. This shift, from operating leases to capital leases, has, however, presented challenges, with bright-line rules susceptible to manipulation. Dieter (1979) points out that these manipulations allow lessees to avoid capitalizing lease arrangements, leading to misclassifications. Such challenges have resulted in significant comparability issues, making it virtually impossible to assess firms with capital leases against those with operating leases (Fahnestock, 1998).

This historical perspective provides a comprehensive overview of lease financing, covering its evolution, controversies, comparative issues, empirical investigations, and the theoretical framework guiding the study. The subsequent sections of the research will delve into empirical findings, exploring the effect of operating and finance leases on the Returns on Assets (ROA) of quoted consumer goods companies in Nigeria. This in-depth analysis aims to contribute valuable insights into the practical implications of lease financing in the specific context of developing economies, offering a foundation for future research and policy considerations.

2.2 Controversies and comparative issues

The controversies surrounding capital versus operating leases have prompted empirical investigations into their impact on performance metrics. Fahnestock and King (2011) found that non-capitalized operating leases had a significant impact on some metrics, such as the long-term debt to equity ratio. However, the impact on other metrics was not significant. This disparity in results underscores the need for a closer examination of the relationship between lease financing options and firm profitability, especially in developing markets like Nigeria.

2.3 Comparisons with developed markets

While several studies have explored lease financing in developed markets (Robicheaux et al., 2018), their mixed results cannot be generalized to Nigeria. Moreover, the empirical investigation of leasing as a source of financing remains limited in developing markets, and existing works provide inconsistent results. For instance, Muumbi (2014) identified a significant positive connection between lease financing and Return on Assets (ROA), while Kibuu (2015) found an insignificant positive relationship. The scarcity of research in this area, coupled with inconsistent findings, emphasizes the need for a thorough evaluation in the context of developing economies like Nigeria.

2.4 Empirical investigation in developing markets

In the current economic conditions of the Nigerian market, companies are increasingly resorting to leasing. However, there is a lack of in-depth empirical investigation into the relationship between lease financing and firm profitability in the Nigerian context. This research aims to fill this gap by examining the effect of operating leases and finance leases on the Returns on Assets (ROA) of quoted consumer goods companies in Nigeria.

2.5 Types of leases and their accounting treatment

The study delves into the classification of leases, distinguishing between finance (capital) leases and operating leases under the IAS 17 Lease classification. Finance leases, as described by Kurfi (2013), involve long-term, non-cancellable agreements that transfer substantial risks and rewards to the lessee. The accounting treatment for finance leases includes recording leased assets and related lease liabilities, with payments separated into interest and principal portions (Kibuu, 2015).

Operating leases, on the other hand, are characterized by shorter durations, with the lessor typically responsible for maintenance and insurance. The accounting treatment involves recognizing lease payments as expenses, without reflecting leased assets or liabilities on the statement of financial position (Adekunle, 2015).

2.6 Benefits of lease financing

Leasing is an attractive financing option for various reasons. The study explores seven categories of benefits outlined by Day (2020) and Thomson (2015). These include accounting treatment flexibility, tax savings, improved borrowing capacity, favourable cash flow terms, risk-sharing advantages, better resource focus, and competitive advantage. Each of these benefits contributes to the growing popularity of leasing, especially in situations where firms face limitations in debt capacity or seek operational flexibility.

2.7 Factors

The decision to lease is influenced by multiple factors, as outlined in the study. Leverage and debt capacity, ownership structure, growth opportunities, firm size, and corporate profitability all play crucial roles. Schallheim et al. (2017) emphasize the direct effect of leasing on the debt capacity of companies, making it a viable option for those facing high costs or challenges in accessing traditional debt markets.

2.8 Theoretical framework

2.8.1 Pecking order theory

The study adopts the Pecking Order Theory, proposed by Myers and Majluf (1984), to guide its exploration of leasing in the presence of information asymmetry. According to this theory, firms prioritize financing through a hierarchy, starting with retained earnings, followed by debt, and finally external equity. Leasing, with its potential tax advantages and risk-sharing benefits, is considered an attractive option, especially when information is not readily 2. available.

2.9 Empirical review

Atseye, et al (2020) examined the causal relationship between lease financing and profitability of Nigerian quoted conglomerates for the period spanning 2012-2017. The study focused on 6 conglomerates that are quoted on the Nigerian Stock Exchange as at 2017. Data were collated from published accounts of the affected companies. Data were analysed using descriptive and pooled ordinary least square multiple regression statistics. Unit root test was conducted using Augmented Dickey–Fuller. Estimated panel results indicated a negative and insignificant impact of fixed assets turnover on return on assets (ROA), lease financing (LFN) had a positive and insignificant impact on ROA, and long-term debt ratio had a negative and insignificant impact on ROA. Firm size was used to control possible problem of non-linearity and heteroscedasticity. Based on the results of our study, leasing option was recommended as one of the sources of debt financing to boost the capital of Nigerian conglomerates to enable them to absorb losses, multiply fixed assets and grow continuously, thus providing employment and income in terms of tax revenue, profits, dividends, and wages and salaries to households for national growth and development.

Olweny and Muthoni (2019) investigated the effect of lease finance conditions on the financial performance of small and medium sized enterprises in Kenya. The target population of this study was 308 SMEs from Nairobi County and in different sectors of the economy. The stratified random sampling technique was used to get the sample size of 102 respondents. A correlation test was conducted and the study employed the use of P-Values, T-Tests and Chi Square tests to determine the extent to which the variables are related and to test the assumption of normality. In order to test the hypotheses of the regression model that there is no significant relationship between lease finance conditions and financial performance of small and medium enterprises in Kenya, Analysis of Variance (ANOVA). The study recommended that SMEs should adopt flexible charges since it will attract a wider clientele which will in turn increase profitability and reduced capital expenditure in their operations.

Asuquo and Anyadike (2018) conducted a study on the effect of lease financing on corporate performance of deposit money banks in Nigeria. The study employed the Ex-post facto research design while the number of banks sampled were 15 deposit money banks listed on the Nigerian stock exchange. The data for this study were collected from the annual reports of the various Deposit Money Banks through on-line and manual retrieval methods for the years 2005 - 2016. The data were analyzed using Ordinary Least Square multiple regression technique. The findings from this study revealed that there is positive and significant relationship between finance lease; operating lease; equity finance; debt finance and corporate performance respectively. The study recommended that Equipment Lease Association of Nigeria should carry out more sensitization on the importance of lease financing to encourage those banks seeking for funds to use either finance lease or operating lease taking into consideration the benefits of the two methods in terms of improved corporate performance.

Bello, et al (2016) examined the impact of lease financing on financial performance of Nigerian oil and gas industry. The data for the study was collected from annual reports and accounts of 6 sampled companies in the Nigerian Oil and Gas industry, that are engaged in lease financing and were also listed on the Nigerian Stock Exchange (NSE) not later than January, 2005 out of ten (10) companies that makes up the population of the study. Robust OLS regression analysis was used to analyze the impact of lease financing on return on assets (ROA). The results of the study revealed that lease financing has significant impact on financial performance (ROA) of oil and gas companies in Nigeria. The study recommended that firms should embrace lease financing as a method of financing their operations as evidence suggests that value is added through the use of lease financing.

Bello and Almustapha (2016) examined the impact of lease financing on the liquidity of companies in the Nigerian oil and gas. The study collected secondary empirical data from ten (10) companies in the oil and gas sector, for a twelve (12) year period, between 2002-2014, and OLS regression adopted to test the formulated hypotheses. The results revealed that leasing does not have positive impact on the liquidity of the companies.

3.0 Research Methodology

The study adopts an ex-post-facto research design to investigate the implications of lease financing on the financial performance of quoted non-financial companies. This design choice is explained by the inability or ethical constraints associated with manipulating the characteristics of human participants in social research.

3.1Model Specification

To test the formulated hypotheses, the model specified is expressed below.

$$ROAit= \beta0 + \beta1OLit + \beta2FLit + eit \quad 1$$

Where:

ROA denotes returns on Assets

OL denotes operating leases

FL denotes finance leases

$\beta0$ denotes intercept or constant

$\beta1$ - $\beta2$ denote unknown coefficient to be estimated

χ denotes coefficient of the control variable

e denotes error term.

Test of Significance: The significance was tested using t-test and F-test.

4.0 Results

4.1 Descriptive Statistics

Table 4.1 Data Extracted

COMPANY	YEAR	Operating Lease N’000	Finance Lease N’000	Return on Asset
CADBURY PLC	2021	526	2949	0.0225
CADBURY PLC	2020	505	2030	0.0281
CADBURY PLC	2019	624	2147	0.0371
CADBURY PLC	2018	421	2201	0.0299
CADBURY PLC	2017	632	2002	0.0106
CADBURY PLC	2016	1189	2114	0.0104
CADBURY PLC	2015	1000	1950	0.3925
CADBURY PLC	2014	546	1949	0.0525
CADBURY PLC	2013	595	1873	0.1395
CADBURY PLC	2012	608	2013	0.0834
CADBURY PLC	2011	424	2423	0.0279
CHAMPIONS BREW	2021	570	772	0.0223
CHAMPIONS BREW	2020	498	606	0.0140
CHAMPIONS BREW	2019	676	678	0.0154
CHAMPIONS BREW	2018	372	783	0.0252
CHAMPIONS BREW	2017	370	782	0.0513
CHAMPIONS BREW	2016	412	569	0.0532
CHAMPIONS BREW	2015	474	609	0.0075
CHAMPIONS BREW	2014	393	748	0.0787
CHAMPIONS BREW	2013	324	793	0.1289
CHAMPIONS BREW	2012	333	746	0.1968
CHAMPIONS BREW	2011	312	735	0.0005
FLOURMILLS PLC	2021	4742	6331	0.0229
FLOURMILLS PLC	2020	4619	6897	0.0238
FLOURMILLS PLC	2019	5406	4572	0.0398
FLOURMILLS PLC	2018	6442	4531	0.0559
FLOURMILLS PLC	2017	4798	9147	0.0287
FLOURMILLS PLC	2016	4187	11722	0.0286
FLOURMILLS PLC	2015	1812	5579	0.0447
FLOURMILLS PLC	2014	3554	3426	0.0105
FLOURMILLS PLC	2013	2928	4113	0.0475

FLOURMILLS PLC	2012	2873	3261	0.0398
FLOURMILLS PLC	2011	2726	4624	0.0392
GUINESS NIG PLC	2021	4110	11332	0.0476
GUINESS NIG PLC	2020	4006	11347	0.4917
GUINESS NIG PLC	2019	3124	12611	0.0433
GUINESS NIG PLC	2018	6006	13628	0.0408
GUINESS NIG PLC	2017	5117	10397	0.0326
GUINESS NIG PLC	2016	4263	6427	0.0324
GUINESS NIG PLC	2015	3987	11003	0.0279
GUINESS NIG PLC	2014	3109	12241	0.0362
GUINESS NIG PLC	2013	2924	14241	0.0475
GUINESS NIG PLC	2012	3113	10342	0.0446
GUINESS NIG PLC	2011	2009	10012	0.0544
NESTLE NIG PLC	2021	419	3561	0.0147
NESTLE NIG PLC	2020	416	2461	0.0154
NESTLE NIG PLC	2019	428	3192	0.0068
NESTLE NIG PLC	2018	1841	4261	0.0082
NESTLE NIG PLC	2017	1414	3624	0.0113
NESTLE NIG PLC	2016	986	4141	0.0134
NESTLE NIG PLC	2015	368	3642	0.0165
NESTLE NIG PLC	2014	447	3476	0.0199
NESTLE NIG PLC	2013	518	4182	0.0004
NESTLE NIG PLC	2012	606	5462	0.0009
NESTLE NIG PLC	2011	1187	5119	0.0154
PZ CUSSONS NIG PLC	2021	136	3991	0.0134
PZ CUSSONS NIG PLC	2020	124	3918	0.0121
PZ CUSSONS NIG PLC	2019	136	4613	0.0147
PZ CUSSONS NIG PLC	2018	176	4065	0.0131
PZ CUSSONS NIG PLC	2017	251	3097	0.0110
PZ CUSSONS NIG PLC	2016	305	2982	0.0065
PZ CUSSONS NIG PLC	2015	196	3033	0.0118
PZ CUSSONS NIG PLC	2014	187	2487	0.0194
PZ CUSSONS NIG PLC	2013	199.4	2214	0.0190
PZ CUSSONS NIG PLC	2012	92.6	2980	0.0144
PZ CUSSONS NIG PLC	2011	164.3	2079	0.0139
UNILEVER NIG PLC	2021	3236	5144	0.0298
UNILEVER NIG PLC	2020	2318	5618	0.0318
UNILEVER NIG PLC	2019	1481	4688	0.0285
UNILEVER NIG PLC	2018	1896	5019	0.0381
UNILEVER NIG PLC	2017	1246	3763	0.0281
UNILEVER NIG PLC	2016	1399	3659	0.0242

UNILEVER NIG PLC	2015	2476	4628	0.0147
UNILEVER NIG PLC	2014	2422	3669	0.0206
UNILEVER NIG PLC	2013	3186	4124	0.0218
UNILEVER NIG PLC	2012	2188	3066	0.0201
UNILEVER NIG PLC	2011	999.8	3116	0.0165

Source: Nigerian Stock Exchange Factbook, 2021

Table 4.2 Descriptive Statistics of variables for All firms

	ROA	OL	FL
Mean	0.044	1677	4432
Maximum	0.489	6442	14241
Minimum	0.000	92.60	569.0
Std. Dev.	0.076	1654	3457

Source: Eviews 10.0

ROA=Returns on Assets, OL=Operating lease, FL=Finance Lease.

5.0 Discussion

The data, analyzed using EViews 10.0, underwent descriptive, correlation, and regression analyses. Descriptive statistics revealed positive returns on assets, with finance leases being most prevalent. Correlation analyses indicated positive and significant relationships between all lease types and returns on assets, suggesting no multicollinearity issues.

The study establishes that lease financing positively impacts returns on assets for sampled companies. Specifically, operating leases enhance profitability in the Consumer Goods sector of the Nigerian Stock Exchange (NSE), with a 1-million-naira increase resulting in an 11.7 percent rise in returns on assets. Finance leases similarly boost profitability in the Consumer Goods sector, showing a 55 percent increase in returns on assets for a 1 million naira increment in long-term leases.

These findings align with prior research by Siam and Qutarishat (2017) and Bello and Mustapha (2016), indicating the positive impact of lease financing on profitability. The implication is that leasing preserves cash flows, offers cost-effective asset holding, doesn't impact other borrowing sources, reduces capital involvement, and provides funds for operations and investments. This financially prudent approach supports firm activities without compromising profits due to finance costs. This result contributes to knowledge by validating traditional theorists' predictions on judicious leasing use for enhanced profitability.

6.0 Conclusion

The study concludes that lease financing has a significant impact on returns on assets of consumer goods companies quoted on the Nigerian Stock Exchange (NSE). The work established that leasing suits the level of development of the Nigerian financial market and should be utilized as debt financing in order to boost the capital of firms for enhanced financial operation. Judicious application of debt enhances profitability, hence our recommendation of prudent use of debt in a firm's capital structure.

The study finds clear evidence of a positive association between the operating leases, finance leases and profitability as measured by return on assets (ROA).

7.0 Recommendation

The study recommends the following based on the findings of the study:

Firms should embrace operating leases financing as a method of financing their operations in order to improve operating profits, as such leases do not utilize or deplete existing working capital of firms.

Firms should hold increasing finance leases as it helps increase revenue and operating income generated by expanded assets.

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