

Impact of lease finance on performance of SMES in Pakistan

Muhammad Jawad Khalil¹, Imtiaz Ahemad², Haris Javed³, Shahzad Atta⁴, Muhammad Nadeem^{5,*}

¹MS Scholar, ²PHD Scholar, ^{3,4}MS Scholar, ⁵Lecturer, ¹National University of Modern Language, Islamabad, Pakistan, ²North China University of Water Resources & Electric Power, ^{3,4}Natioanl University of Modern Languages Islamabad, Pakistan, ⁵National University of Modern Language Multan

***Corresponding Author:**

Email: muhammadnadeem19@gmail.com

Abstract

Lease finance decision is one of the major decisions in the organizations because it affects the whole organization. Organizations need funds to operate successfully and conveniently in accordance to meet the financial requirements. Lease finance is one of the critical things which is included in the strategies of the organizations. This research article tried to assess and evaluate the impact of lease finance on the financial performance of the SMEs in Pakistan. Return on Assets (ROA) and Return on Equity (ROE) are evaluated in order to assess the performance of the organization in accordance to financial health of the organization. Content analysis is used with the help of a questionnaire. Total number of SMEs is 52 which will be the population for our research study. Pakistani entrepreneurs of SME's are the respondents for our research article. The association of lease finance and financial performance of the organizations is measured by using cross-sectional data. On the basis of regression results it has been observed that there is a positive and significant association between Return on Assets (ROA) and lease finance. There is positive and significant connection between Return on Equity (ROE) and lease finance. It is clear from the results that lease financing has enhanced the performance of the SMEs in Pakistan therefore it is recommended the it should be involved more habitually in SMEs of Pakistan.

Keywords: Lease finance, Performance, ROE, ROA, SMEs, Pakistan.

Introduction

Lease financing is a concept which is well known in the developed countries but in some developing countries lease financing is not well known comparatively. Although many lease financing companies are working in Pakistan but few are known by the entrepreneurs due to lack of awareness. Basically mostly people know the concept of banks to avail the finances whereas lease financing institutions are not the banks. Lease financing institutions are providing funds to the SMEs in Pakistan and their role is unavoidable in the enhanced performance of SMEs. In the developing countries like Pakistan lease financing companies are the backbone of the economy. Lease financing companies are providing funds to the small and medium size firms in the countries which strengthen the economy of the countries. According to Salam, (2013) Entrepreneurs with their creative ideas have attained success through lease financing companies by getting funds to true the dreams. It has observed that lease financing companies achieved their purpose of prosperity in the developed countries and also doing so far in the developing countries.

Financial structure of the organizations is very crucial to capture the growth opportunities in the competitive markets. The performance of the organizations is very much depending on the sources from their assets is attained (Williamson, 1988). The timing of getting funds is also critical for the organizations to get the better results by using those funds. Fortunately lease financing companies are able to give funds to the organizations to succeed in the

global competition. In the third world countries like Pakistan not only SMEs but also so many large size organizations are using lease financing strategies and getting desired results without any difficulty. In the lease financing there are two parties involved in which one party agrees to provide the desired assets to the other part on rental basis and payments in shape of fixed amounts are made on contractual basis (Jarvis, 2000).

Literature Review

Lease financing is not new in Pakistan but due to the lack of awareness in Pakistan it is not as recognized as it should be. In Pakistan first lease financing company was established in 1985. Only six leasing companies were established in Pakistan till 1992 but after that 27 companies were also operating in the market within next five years. Lease financing companies facilitate the small and medium size companies which have few sources to generate the funds. Small and medium size companies have lack of capital and low capacity to borrow from banks or other financial institutions. In 1985 leasing companies could start their business with Rs. 50 million but this limit was enhanced to Rs 100 million and after that it was further enhance to Rs 200 million which created problems for the leasing companies to operate in Pakistan. Due to the lack of awareness among the people, availability of facilities, lack of encouragement and policies of the SECP, companies lost their interest which caused reduction in the operations of the lease financing companies in Pakistan.

Different choices are available to the organizations to for taking decisions regarding capital structure of the organizations. Debt portion has significant role in measuring the performance of the organizations (Boobyer, 2003). Companies prefer leasing over borrowing due to the many reasons. In the borrowing of the assets, the ownership of the asset still remain in the hands of the owner and the owner of the assets also get the benefits of the tax deduction. According to (Finucane, 1998)in case of lease financing companies get the required assets from the owner of the asset on the basis of contractual payments and the lessee or the user of the asset is not compelled to buy the asset. At the end of the contract the user of the asset can buy the asset on market price or less but the lessee is not bound to buy the used asset or equipment. The main purpose for these strategies is to maximize the wealth of the shareholders and to increase the worth of the organization. According to Graham, Lemmon and J. S., (1998) Management of the organizations is responsible to satisfy not only the shareholders but also to the workforce of the organizations.

Many countries have adopted lease financing as their strategy in the recent past and they have attained unexpected useful results by doing so. Not only the developed countries but also the developing countries are adopting the option of lease financing over borrowing or loans (Lewellen, S. L. and McConnell 1976). Kenya, Bangladesh have recently attained benefits from lease financing strategies. Debts or loans are more beneficial to those organizations which are able to use them efficiently and affectively otherwise it is a burden for the organization. If the organizations are earning enough revenues before tax to settle the loan payments than it is useful for the organizations (Lasfer, 1998). It has been observed in the developing countries that they are nor using their loans efficiently which is the major reason for their failure and unsatisfactory financial performance (Johnson, 2003). In Pakistan the effects of lease financing on the SMEs are not measured in past therefore it is the objective of our research to assess whether the lease financing is effecting SMEs positively or negatively in Pakistan.

H1: There is a positive relationship between lease finance and ROA for Medium size enterprises.

H2: There is a positive relationship between lease finance and ROE for Medium size enterprises.

H3: There is a positive relationship between lease finance and ROA for Small size enterprises.

H4: There is a positive relationship between lease finance and ROE for Small size enterprises.

Methodology

To assess the association between the lease financing and the performance of the organizations data is collected from primary sources and secondary sources as well. A questionnaire was developed for the primary data collection. Questionnaire was floated to the entrepreneurs of small and medium size organizations to gather the data. . Total number of SMEs is 52 which will be the population for our research study. 21 medium size organizations were selected whereas 31 small size organizations were selected to measure the results for hypothesis. Regression analysis are used to assess the impact of lease financing on the performance of the organizations. Return on asset (ROA) and Return on equity (ROE) are measured to know the performance of the organizations. Return on asset is the revenues of the organizations after tax deduction divided by total assets. Return on asset shows that how much organization has earned by using its assets after paying all applicable taxes. Return on equity is measured through income of the organizations after tax divided by the outstanding capital of the organization. Return on equity shows that how much an organization has earned by using its equity.

Findings

Regression analyses are used to measure the results for the collected data. The purpose is to assess the association between the lease financing and performance of the small and medium size organization in Pakistan.

Table: 1 Regression Analysis (Lease Financing and ROA)

Hypothesis	Structural Path	Coefficient		T-value	Significant/ In-significant
		B	Standard		
H1	LF → ROA	11.518	9.2943	2.97	Significant

R-square =0.261 F=8.762, Sig= <0.007***

It is clear from the results of table 1 that value of B is positive and T value is 2.97 which is greater than 2. P value is 0.007 which is less than 0.05. The results showed a positive and significant effect of lease

financing on the return on assets in the medium size organizations in Pakistan. It is obvious from the results that medium size organization should use lease financing instead of loans to meet their requirements.

Table 2: Regression Analysis (Lease Financing and ROE)

Hypothesis	Structural Path	Coefficient		T-value	Significant/ In-significant
		B	Standard		
H2	LF → ROE	10.946	8.4619	3.192	Significant

R-square=0.259 F=9.481, Sig= <0.006***

The results of table 2 are showing a positive and significant association between the lease financing and return on equity. P value is 0.006 which is less than 0.05 and T value is 3.192 which is greater than 2 and

acceptable for the hypothesis. It means with the improvement in lease financing the return on equity of the medium size organizations will also improve.

Table 3: Regression Analyses (Lease Financing and ROA)

Hypothesis	Structural Path	Coefficient		T-value	Significant/ In-significant
		B	Standard		
H3	LF → ROA	7.331	4.8519	3.759	Significant

R-square =0.357 F=14.784, Sig= <0.002***

There is positive and significant relationship between the lease financing and return on assets in the small size organization. From the results it is obvious that P value is less than 0.05 and value of B is positive.

T value is greater than 2. Return on equity in the small size organizations will enhance due to increase in the lease financing in Pakistan.

Table 4: Regression Analysis (Lease Financing and ROE)

Hypothesis	Structural Path	Coefficient		T-value	Significant/ In-significant
		B	Standard		
H2	LF → ROE	6.482	3.9452	2.7493	Significant

R-square =0.219 F=12.549, Sig= <0.004***

The results of table 4 are showing positive and significant relationship between the lease financing and return on equity in the small size organizations in Pakistan. Return on equity is the return on the investment of the shareholders. If the return for the entrepreneurs is increasing due to increase in the lease financing than the attraction of lease financing will increase for the entrepreneurs in the organizations.

the small and medium size organizations can be improved by enhancing the lease financing. The overall performance of the economy is dependent upon the performance of the small, medium and large size organization therefore the small and medium size organization have crucial impact on the performance. Management of the small and medium size organizations should realize the importance of lease financing.

Conclusions

It is obvious from the findings of the research that the financial performance of the medium size organizations are directly affected by the lease financing decisions. With the increase in lease financing the performance of the organizations is improving. Return on assets are showing the positive and significant relation with the lease financing. Return on assets in increasing with the improvement in the lease financing of the organization. The results show that there is also positive and significant relation between return on assets and lease financing of small size organizations.

This research study will help to understand that in the developing countries like Pakistan, performance of

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