Effect of Leasing Competence and Structure on Performance of Small and Medium Enterprises in Kisii Municipality, Kisii County

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Abstract
In Kenya, leasing is bridging the current fixed-asset financing gap experienced by SMEs, and efforts have been made to improve the leasing competences of SME managers with the aim that they are able to negotiate for favorable lease terms which reflect firms' cash flows. Despite these efforts, many SMEs use inefficient equipment and tools and others enter into unfavorable lease contracts. Lease competence was assessed in terms of leasing cash flow preparation and negotiation skills. Sales revenue, lease cash flows and lease operating costs were tabulated over the lease period. Summated weighted averages and multiple regression were used to analyze. Results were presented using tables and charts. The study established that most SME managers had low competence in preparation of expected cash flows. Also it was established that there is a significant relationship between leasing competence and lease structure on performance. The study concluded that SME managers be trained in long-term planning also most SMEs are straining to meet their contractual obligations in lease agreements. The study recommends more investment in initiatives to improve leasing competence of SME managers. Also study recommends to the Kenyan government to institute specific laws to regulate and govern lease transactions and put in place specific tax exemptions for lessee SMEs to ease cash outflow burden.
Keywords: Competence, Lease structure, Performance, Enterprises

INTRODUCTION

Access to finance tops the list of constraints faced by SMEs everywhere. In Kenya, it is leasing that is touted to bridge the current financing gap experienced by SMEs by providing commercial and industrial equipment as it focuses on the lessee's ability to generate cash flow from the business operations to service the lease repayment rather than on the balance sheet or past credit history, (International Finance Corporation (IFC), 2007). The terms of a given lease contract constitute a lease structure and these include: length of the lease term, operating cost, lease rentals, reviews and incentives and according to Kisaame (2007), lease structure varies from one lease contract to another. SMEs are predominantly owner-managed and sole proprietorship is the norm, and the leasing competences of managers are cited as one of the key factors that influence performance of SMEs, (Taylor, 2001). A lot of effort has been made to improve the leasing competence of SME managers through provision of a wide range of business support services. In spite of all that, performance of SMEs in Kenya continues to decline due to cash flow challenges, occasioned by use of inefficient equipment and tools and unfavourable lease structure. What remains unclear is how the leasing competence of managers/owners affects lease structure and the performance of SMEs. The study sought to evaluate the effect of leasing competence of managers/owners and lease structure of a lease agreement on performance of SMEs, in Kisii Municipality, Kisii County and was guided by the following specific objectives:

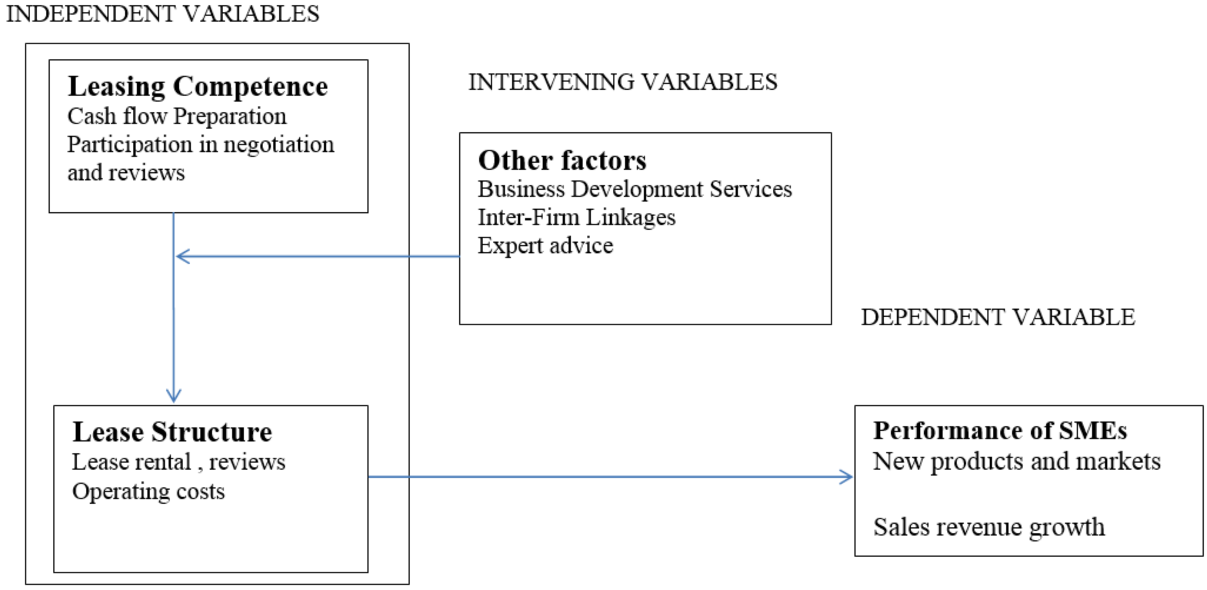
i) Assess the leasing competence of lessee SME managers in Kisii Municipality;
ii) Evaluate the effect of lease structure on performance of SMEs.

LITERATURE REVIEW

Leasing competence has been defined as a set of leasing knowledge, leasing attitudes and leasing skills that a person possesses (Ellstrom, 1997). According to IFC (2006), leasing skills include lease negotiations, lease cash flow planning. The ability to negotiate helps a lessee to come up with a lease structure that best suits the organization's aims and objectives. Research has consistently shown that SMEs don't engage in long term planning. This is much at odds with strategy literature that dictates that an enterprise must actively plan for the future (Ennis, 1998). Leasing involves contractual obligations, especially finance leases which are long term in nature. Thus lease planning is a critical skill for a lessee SME. Lease agreements are drafted differently from firm to firm. The terms of a given lease contract constitutes a lease structure. A lease structure is an important finance decision firms are confronted with (Abor, 2007). This position was also emphasized by Rowland (2000) who asserted that lease clauses influence rental value because they shift opportunities, responsibilities and risks between two parties. Rental payments can be structured to be monthly or quarterly depending on the nature of business and its cash flow profile (East African Development Bank, 2004). Leasing incentives are concessions given to lessees to entice them into signing new leases. In a competitive leasing industry, lease incentives are perceived as an important factor in luring and keeping clients. Lease incentives include abnormal rent free periods and caps to rent increases on review. Firm performance can be measured by sales growth, and development of new markets and products (Taglianvini *et al.,* 2002). Watson et al, (2004), whose research on SMEs in Scotland revealed that businesses with leasing competence are on average more profitable this is so because leasing competence contributes to growth of a firm through raising productivity and facilitating the adoption and use of new technologies, upgrade production, financial capabilities and flexibly respond to market forces. However, the relation between leasing competence and SME performance remains highly unresolved. This unsettled debate warranted further research. A recent research conducted by Abor (2007) on Ghanaian SMEs shows that long-term debt has a significantly positive relation with good performance. This means that long term leasing could have a significant positive relation with financial performance of SMEs. However, in Kenya, this is not clear. From the foregone review of existing literature, it is clear that there is no conclusive agreement on the effect of leasing competence and lease structure on SME performance yet SMEs are unanimously considered to be critical in the economic development of any economy.

The conceptual framework below demonstrates the influence of leasing competence on lease structure of a lease agreement and the relationship between the lease structure and firm performance.

Figure 1



Source: Researchers

METHODOLOGY

The study adopted a case study design. According to Oso & Onen (2005) case study design is ideal for a researcher seeking to sample and describe events or opinions without manipulating variables. The target population consisted of all 32 SMEs manager/owners whose firms are located in Kisii Municipality and had lease-financed their assets. The researcher employed census survey. The five point Likert scale questionnaire was used to obtain data on the leasing competences of managers, the lease structure negotiated by SMEs that had leased assets and their performance. Further sales revenue, lease cash flows and operating costs over the lease period were tabulated. Validity was ensured through constantly seeking expert advice from peers and the supervisors. The reliability of the questionnaire items was determined through test-retest method in which pilot results gave a Pearson's correlation co-efficient of 0.877 which is greater than 0.5.This implies adequate reliability of the research instrument (Kerlinger, 1986). Descriptive statistics was used to analyze data aided by the summated weighted averages. Regression analysis was used to develop a model to predict the effect of lease structure (lease rentals and operating costs) on the performance of SMEs (sales revenue). The significance level of the regression co-efficient was determined using t-tables at 95% confidence level. The general regression model (Mugenda and Mugenda, 2003),

$$Y= \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \ldots\ldots + \beta_n X_n + \alpha \quad \ldots\ldots\ldots\ldots\ldots\ldots (1)$$

Where **Y**= is the dependent variable; $\mathbf{X_{1\ldots n}}$= are the independent variables; $\boldsymbol{\beta_0}$ = is the constant; $\boldsymbol{\beta_{1\ldots n}}$= are the regression co-efficients or change induced on in Y by each **X** and **α** = is the error. For this study, **Y**= Sales revenue (sh); $\mathbf{X_1}$= Operating costs (sh). $\mathbf{X_2}$= Rental amounts paid (sh). The results were presented using tables and charts.

RESULTS AND DISCUSSIONS

Leasing Competences of SME Managers

The first research objective of this study was to assess the lease competence of lessee SME managers. Competence was assessed on basis of preparation of cash flow plans, participation in lease negotiations. Summated weighted averages method was used to analyze data as shown below.

Preparation of Cash flow Plans

Table 1 below shows that 65% of managers prepare plans to some extent on score 3.75% of managers peg their payment of lease rentals on firm's cash flows. However, considering prompt payment of lease rentals, 75% are not prompt. This is an indication that most firms are straining to pay lease rentals. With weight of 1.063 virtually all firms don't carry out tax planning. This is because most SMEs are not registered with Kenya Revenue Authority. Therefore, this outcome confirms findings by Sandberg et al, (2001) that most SMEs don't engage in long term planning.

Table 1: Analysis of Competence of SME Managers to Prepare Cash Flow Plans

Indicators	V. great Extent 5	Great Extent 4	Moderate Extent 3	Less Extent 2	Least Extent 1	$\sum f_i$	$\sum f_i w_i$	$\frac{\sum f_i w_i}{\sum f_i}$
Prepare expected cash flows	0	0	20	7	5	32	79	2.469
Carry Tax planning	0	0	0	2	30	32	34	1.063
Develop new lease rentals on review	0	5	7	17	3	32	78	2.438
Relate rent payment to cash flow generation	4	7	13	8	0	32	103	3.219
Prompt rental payment	1	3	4	14	10	32	67	2.094

Source: Primary Data

Managers' Participation Competence in Negotiations and Reviews

Table 2: Analysis of Findings on Participation in Lease Negotiation and Reviews

Indicators	V. great Extent 5	Great Extent 4	Moderate Extent 3	Less Extent 2	Least Extent 1	$\sum f_i$	$\sum f_i w_i$	$\frac{\sum f_i w_i}{\sum f_i}$
Negotiate agreement to suit unique firm's needs	3	5	11	10	3	32	91	2.844
Evaluate terms before signing contract	17	11	2	2	0	32	155	4.844
Participate in reviews to ensure are reasonable	11	14	3	1	3	32	125	3.906
Seek clarification on unclear clauses	5	8	14	2	3	32	106	3.313

Source: Primary Data

From table 2 above, analysis of findings shows that most managers evaluate other lessors in the market (4.844). 25% of managers are conscious of the unique needs of their firms on score 4 and 5 while 40% don't give much consideration. However on score 4 and 5, 78% of managers do participate in reviews to ensure they are reasonable. This is occasioned by the strain of paying lease rentals. Despite the importance of clarification on lease clauses 15.6% of managers on score 1and 2 seem to commit into lease contracts even with some grey issues of agreement.

Lease Structure of Firms
Analysis of Rental Reviews, Incentives
Table 3: Findings on Rental Reviews and Incentives.

Indicators	Strongly Agree 5	Agree 4	Neutral 3	Disagree 2	Strongly Disagree 1	$\sum f_i$	$\sum f_i w_i$	$\frac{\sum f_i w_i}{\sum f_i}$
Rentals cause financial constraint	14	11	4	3	1	32	129	4.031
Contract provides for rent review	5	13	11	3	0	32	106	3.313
Reviews done after long period	10	8	11	1	2	32	123	3.844
Agreement provides for grace period	6	17	2	4	3	32	115	3.594
There are ceilings on rent increase on review	8	11	7	3	1	32	112	3.500

Source: Primary Data

Analysis of findings on lease structure items in table 3 above; rentals reviews and incentives, weight of 4.031 implies most firms are straining to pay lease rentals. This reinforces the fact that most managers don't prepare cash flow plans as observed earlier. Weight 3.844 means most firms long for reviews believing rentals will reduce on review to relieve them the cash flow strain. Most contracts have incentives of grace periods and ceiling on rent increase as evidenced by weights 3.594 and 3.500 respectively. This is so because of competition among lessors to woo more lessees. (Robinson, 1999)

Length of Lease Term of SMEs in Kisii Municipality
Referring table 4 below, most firms do contract lease term equivalent to life of the asset (3.219). The asset leased is to be used in many projects (2.500). Further many managers consider the lease contract period is not long enough hence least weight of 1.969. This confirms managers lack competence to negotiate for term suitable to unique needs of the firm.

Table 4: Findings on Length of Lease Term

Indicators	Strongly Agree 5	Agree 4	Neutral 3	Disagree 2	Strongly Disagree 1	$\sum f_i$	$\sum f_i w_i$	$\frac{\sum f_i w_i}{\sum f_i}$
Term spread over useful live of asset	4	7	13	18	0	32	103	3.219
Lease period relate to firm's project	4	5	3	11	9	32	80	2.500
Length of my firm's agreement is long	1	2	3	15	11	32	63	1.969

Source: Primary Data

Influence of Lease structure on cash flow savings
SME managers were asked to rank the influence of lease structure items on cash flow savings invested in the sales operations. The analysis of findings, suggest rental payments has high weight of 4.375 followed by non-shouldering of operating costs with weight of 3.375 and lastly reviews and incentives with weight of 2.281.These findings suggest that a competent SME owner/manager should negotiate for low rental payments. Therefore, owners/managers should negotiate for a long lease contract periods.

Table 5: Findings of the Influence of Lease Structure on Cash flow Savings

Lease structure items	Most influential 5	More influential 4	Moderately influential 3	Less influential 2	Least influential 1	$\sum f_i$	$\sum f_i w_i$	$\frac{\sum f_i w_i}{\sum f_i}$
Rental amounts paid	17	11	3	1	0	32	140	4.375
Reviews and incentives	0	0	10	21	1	32	73	2.281
Non-shouldering of operating costs	5	10	10	6	1	32	108	3.375

Source: Primary Data

Performance

Findings on perceived performance of the indicators assessed in table 6 below, show that service to new clients has higher weight followed by introduction of new products that is 3.969 and 3.844 respectively. The lowest weight of 2.094 is given to increase in outreach points. This is because firms prefer to operate single outlets which they operate individually and therefore few people are employed. Therefore employment of more workers cannot be strongly associated with increase in demand of firm's product, hence, the weight of 2.563.

Table 6: Findings on perceived performance

Indicators	Strongly Agree 5	Agree 4	Neutral 3	Disagree 2	Strongly Disagree 1	$\sum f_i$	$\sum f_i w_i$	$\frac{\sum f_i w_i}{\sum f_i}$
More workers employed due to high demand	0	3	15	10	5	32	82	2.563
Increase in orders placed by firm's clients	7	17	2	5	2	32	120	3.750
Stocking frequency has gradually increased	3	10	10	7	2	32	101	3.156
Firm serving new clients	15	8	2	6	2	32	127	3.969
Increase in outreach points	0	3	5	16	8	32	67	2.094
Introduced new products to meet new demand	17	3	7	2	1	32	123	3.844

Source: Primary Data

Lease Structure and Performance of SMEs.

Multiple regression analysis was used to deduce a model that could be used to explain the effect of lease structure (operating costs and lease rental payment) cash flows on performance (sales revenue cash flows) of SMEs in Kisii Municipality. Before multiple regression procedures were carried out, the basic assumptions of multiple regression analysis were verified and were satisfactorily met as follows. The concern of multiple collinearity was tested by observing the variance inflation factors (VIF). Subject to the rule of thumb that the number should be less than 9 (Thomas, 2008). All the VIF entries as shown in table 7 below were adequately low hence the possibility of multi-co linearity did not exist.

Table 7: Regression of Lease rent, Operating costs and Sales Revenue.

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations			Collinearity Statistics	
	B	Std. Error	Beta			Zero-order	Partial	Part	Tolerance	VIF
1 (Constant)	34421.943	37513.166		.918	.366					
OperatingCosts	5.106	2.801	.297	1.823	.079	.458	.321	.273	.844	1.184
Lease Rent	-1.028	.411	-.408	2.502	.018	.525	.421	.375	.844	1.184

a. Dependent Variable: Sales Revenue
Source: Primary Data

Table 8: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.591[a]	.350	.305	91354.940

a. Predictors: (Constant), Lease rent, Operating Costs

b. Dependent Variable: Sales Revenue

Source: Primary Data

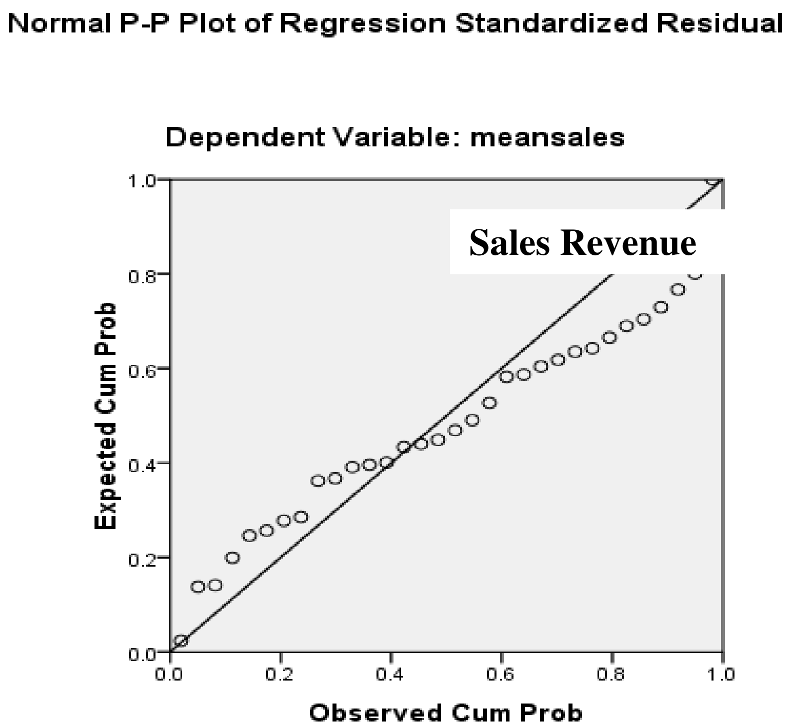


Figure 2
Source: Primary Data

The normality of the dependent variable was checked by the use of normal probability plots (Histogram and normal P-P plot) as shown in figure 2 above. From figure 2 above, it can be observed that the residuals are normally distributed. Further, from histogram below, the regressed standardized residuals are normally distributed.

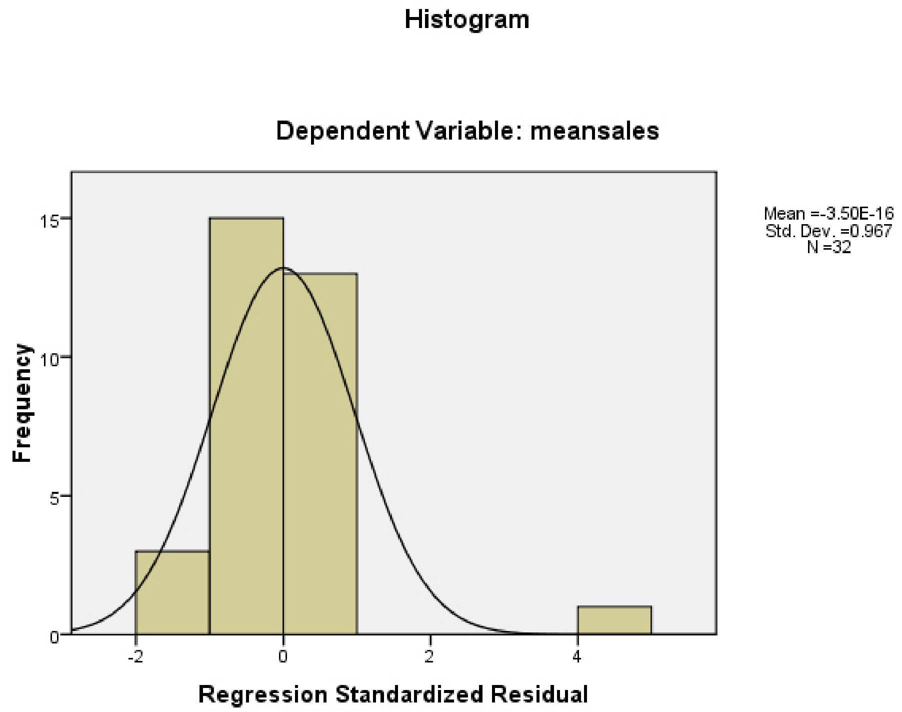


Figure 3
Source: Primary Data

The test for linearity assumption was done by the use of scatter plot in figure 4 below.
From the scatter plot below, we observe that the plot demonstrated a linear pattern.
The assumption of constant variance (homoscedasticity) was checked by visual examination of figure 7; a plot of standardized residuals (the errors) by the regression standardized predicted value. The residuals were randomly scattered around 0 (the horizontal line) providing a relatively even distribution and hence no violations of homoscedasticity were detected.

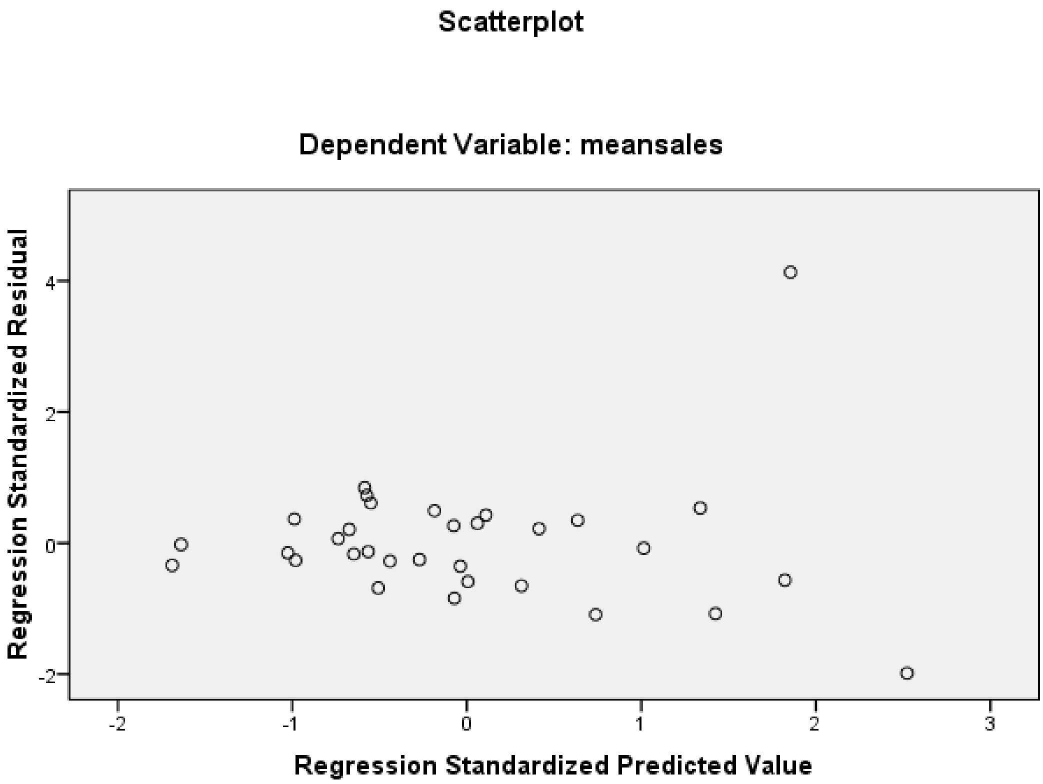


Figure 4
Source: Primary Data

Lease rental payment had the greatest effect on generation of sales revenue with a unit change in the lease rental amount paid, holding operating costs constant, resulting to a 40.8% increase in sales revenue, whereas operating costs had least effect with a unit change in operating costs holding lease rental payments constant, resulting to a 29.7% increase in sales revenue in cash flows. The overall equation as envisioned in the conceptual framework can be represented by use of unstandardized coefficients as follows.

$Y = 34421.943 + 5.106X1 - 1.028\ X_2$ …………….…………………….. (2)

This means that even without the two variables under study, sales revenue cash flows are expected to be Ksh. 34,422. Further, the model coefficient of lease rent is negative. This implies a decrease in rent payment due to reviews leads to a positive increase in sales revenue.

Table 8 above summarizes the regression model. $R^2 = 0.350$. This means that 35% of the variability of sales revenue cash flows could be attributed to changes in lease rental and operating cost cash flows. Comparing the values of R^2 and adjusted R^2 gives a difference of 0.045 which is too small. This shows that the validity of the model is very good since its shrinkage is less than 0.5 threshold suggested by Field (2005).These findings indicate that there is a relatively high support for the existence of a positive significant relationship between performance and lease structure. Generally, researchers have established a positive relationship between performance and lease structure of firms (Tan & Mahoney, 2005; Abor, 2007; Tweed and Massey, 2000). Moreover based on the findings of this study, the central role of leasing competence and lease structure on sales revenue cash flows change has been demonstrated by the empirical data from SMEs in Kisii Municipality. The data analysis indicated that those SME owners/managers competent in leasing matters negotiated for a favourable lease contract which led to high cash outflow savings. These cash flow savings were invested in sales operations which led to high sales revenue generation (performance).

CONCLUSIONS

The first research objective sought to assess the leasing competence of lessee owners/managers. The study established that competence of lessee owners/managers to prepare cash flow plans to be low since they mostly acknowledge straining to pay lease rentals. This study outcome confirms that most lessee SME owners/managers don’t engage in long term planning. Also competence of managers to participate in negotiations of lease agreement is low as they don’t consider unique needs of their firms. This confirms the findings of Abor J. (2007) on debt policy and performance of SMEs in Africa. The findings of the study revealed that lease rentals, reviews and incentives explain up to 52.540% of lease structure, followed operating costs at 13.192% and length of lease term with 6.916%. This confirms what Beyene (2002) contributed. The study concludes that lessees are more concerned with rentals, reviews and incentives than with the length of the lease term and the operating costs like insurance, taxes, repairs and maintenance costs. The second objective of the study was to establish the relationship between lease structure and performance of SMEs. Results from the study indicated that there was a positive significant relationship between the two lease structure items and perceived performance of SMEs. This goes to explain that when the lease structure of lease agreement is favourable to the lessee firm, the firm will perform better. Results from this study agree with a recent research conducted by Abor (2007) on Ghanaian SMEs showing that long term leasing has a significantly positive relation with good performance. SME owners/managers with a high level of leasing competence are better placed to negotiate a favorable lease structure for their firm. In addition, leasing competence positively impacts on the lease structure of the firm thus leading to improved performance of SMEs. Further lessee sales revenue can be predicted by lease rentals and operating costs as evidenced from the regression model. There is need to aggressively improve the leasing competences of SME owners/managers. SMEs, lessors (banks) and providers of SME strengthening initiatives, should invest more in improving the leasing competence of SME owners/managers. This will lead to better customized lease contracts (lease structure) and improved SME performance and ultimately a better economy.The study concentrated on leasing competence, lease structure and performance of SMEs. However there is need for further research in the level of awareness and attitude among non-lessee SME owners/managers towards leasing as a form of finance in Kenya. Also to assess factors influencing the choice of leasing option among medium enterprises in Kenya.

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