Exploring micro-leasing services for poor people’s enterprises

General principles of leasing

Leasing Operation

- Lessor, lessee and equipment supplier are the main parties in a lease
- Terminology includes: Assets, lease term, lease payment, end of lease option

Basic Principles of leasing

- User (Lessee) pays regular amount to equipment owner (lessor)
- Use is separate from ownership
- User generates extra income with little capital outlay
- Owner receives income while retaining ownership
- Leasing is rare in developing countries

Types of leasing

- Financial lease - long term (aircraft)
- Operational lease - short term (car rental)
- Sale and lease back - long term to free up working capital
- Hire - purchase - consumer items (fridges)
Advantages of leasing

- Enables users to gain extra income before large capital outlay in buying equipment needed
- Few collateral requirements
- Evaluation based on future business plan, not past performance
- Tax incentives
- 100% finance keeps working capital in the business
- Low risk of fund diversion

Demands of Leasing

- New systems needed
- Staff training required
- Medium term debt (2-3 years) needed to finance any scheme

Demands of Leasing

- Legal and taxation issues need investigation and clarification
- Market for leasing products including existence of equipment market
- Technical and after-sales support

Limits to Leasing

- Tax advantages sometimes limited
- Difficult in more remote areas
- Working capital constraints of businesses can affect repayments

Marketing a lease product

- Market research
- Understanding the client
- Understanding the equipment / market
- Reaching clients
- Partnerships

Risks of leasing

- Lease portfolio risk
- Residual value risk
- Maintenance and repair risk
- Cost of capital risk
- Currency risk
- Dispute and litigation risk
- Changes in tax regulation
Other leasing issues

- Legal and Regulatory Environment
- Leasing Accounting
- Performance monitoring
- Taxation issues

Further information

- Contact Louis Othieno at Development Outcomes, Vision Plaza, 2nd Floor Suite 37 Mombasa Road. 020 828679 / 80
Leveraged Leasing

A Business Model for Extending the Leasing Market to Small & Microenterprises

Mike Albu
November 2003

Why Leasing for Small Business?

- Assessment of ability to repay based on productive use of asset, rather than previous credit history
- Leasing reduces risks to entrepreneur by spreading costs of investment over time
- Leasing reduces risks to financier because ownership of asset retained
- Tax advantages & incentives for investment can be extended to non-tax paying businesses

Productive Asset Financing

Banks

H.P. companies

SACCO's

M.F.I.'s

Parastatals

Large Corporations

Medium-sized Business

Small Business

Social Enterprises & Assoc's

Informal Microenterprise

Challenges of Leasing to Smaller Enterprises

1. Reduce cost of administering & monitoring large number of small value lease contracts
2. Supplement the security created for lessors by their ownership of assets
3. Broker reliable appraisals of the market for the products and services of lessees’
4. Broker reliable assessments of the commercial value and technical choices of leased assets

Principles of Leveraged Leasing

“Leveraged leasing” targets those industries where many small enterprises (LESSEES) transact regularly with a large corporation (LEVERAGING COMPANY)...• as input suppliers for the larger company, or• as retailers / distributors of their products
a. The lessees and leveraging company agree to buy & sell a sufficient quantity of goods or services to at least cover the value of lease payments
b. The leveraging company undertakes to monitor the lessees, deduct and assign lease instalments directly to the lessor from the payments for goods / services

Business Model for Leveraged Microleasing

FINANCIAL BROKER Commercial Bank

LESSOR Leasing Subsidiary or Division

Capital Equipment Supplier

LEVERAGING COMPANY Large Enterprise

LESSEE Small Enterprise

LESSEE Small & Microenterprise

Microleasing Broker
Advantages of Leveraged Leasing

1. Willingness of a leveraging company to incur extra administrative costs, helps confirm the long-run viability of lessees’ businesses
2. Subsuming administration of lease instalments within the leveraging company’s own financial systems significantly reduces the lessor’s overhead costs
3. The leveraging company is in a privileged position to monitor the performance of leases, since it will become aware of problems in output long before default occurs
4. In the event of lessee default, the lessor has a call not only on the leased asset, but also on any outstanding payments owed to the lessee

Indicative Sectors for Microleasing

<table>
<thead>
<tr>
<th>SECTOR</th>
<th>Small Enterprises</th>
<th>Productive Capital Required</th>
<th>Leveraging Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>VEHICLE MAINTENANCE</td>
<td>Repair Shops, Petrol Stations</td>
<td>Vehicle Maintenance Equipment, Petroleum Companies</td>
<td></td>
</tr>
<tr>
<td>HORTICULTURE</td>
<td>Vegetable Growers</td>
<td>Cultivators, Spinners, Chilens, Export Buyers, Supermarkets</td>
<td></td>
</tr>
<tr>
<td>RURAL ROAD MAINTENANCE</td>
<td>Road Maintenance Contractors</td>
<td>Graders, Compactors, Local Authorities</td>
<td></td>
</tr>
<tr>
<td>HEALTH CARE</td>
<td>Dental surgeries, Diagnostic Labs, Morgue</td>
<td>Dental Equipment, Diagnostic Lab Equipment, Morgue Equipment, Hospitals</td>
<td></td>
</tr>
<tr>
<td>FISH EXPORT</td>
<td>Fishermen</td>
<td>Boats, Cool Boxes, LANDING Jetties, Fish Export Traders</td>
<td></td>
</tr>
<tr>
<td>FRUIT PROCESSING</td>
<td>Fruit Growers</td>
<td>Juice / Pulp Extraction, Storage, Transport, Fruit Juice processing companies e.g. Delmonte</td>
<td></td>
</tr>
<tr>
<td>DAIRY</td>
<td>Dairy Farmers</td>
<td>Milk Chillers, Transport Equipment, Hay Bales, Medium &amp; large-scale dairies e.g. Brookdale</td>
<td></td>
</tr>
</tbody>
</table>

Brokering Role in Leveraged Leasing

- Provide institutions venturing into micro-leasing with advice about the market for leasing productive capital
- Identify specific industries where potential for small-enterprise growth and the opportunities for use of leveraged finance are strongest.
- Conduct technical assessments of the most sought after capital items to identify sources of reliable and technologically appropriate equipment.

A micro-leasing brokerage business should be able to generate revenue from selling these services to lessors and leveraging companies.
**LEASING IN UGANDA**

1st Kenya Leasing Congress  
7th November 2003

Presented by  
Juma Kisaame  
General Manager, DFCU Leasing

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**Importance of SMEs**

- Private sector is key engine of development
- Majority of businesses are SMEs > 90%
- SMEs provide employment - (50%)
- SMEs contribute 2/3 of national income
- Strong developmental impact - bottom up
- Powerful force for poverty reduction
- Foundation for a middle class

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**Challenges of financing SMEs**

- Start ups with limited or no credit history
- Lack of suitable collateral
- Under capitalized
- Corporate Governance
- Red tape and regulation of business
- Fragile sector – informal, no strong voice, lack of sustainability/survival

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**DFCU experience of Leasing to the SME sector**

- State of leasing in Uganda
- Legislation and regulation
- Taxation of leasing transactions
- Accounting treatment
- Benefits of leasing
- Structure of a Finance lease
- Challenges

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**State of Leasing in Uganda**

- Under developed < 1%
- % of total private sector credit < 5%
- Two major players;  
  - East African Development Bank  
  - DFCU Leasing (Mkt Share > 80%)
- Simple finance leases – (2-5 yrs)
- Operating leases
- Focus on SME market

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**Continue >>**

- Competition; globalization, core competence, size, quality of products
- Delays in resolution of commercial disputes
- Poor debt repayment culture
- Limited or lack of investment in IT
- Limited ability to manage the environment on a sustainable basis
**Legislation and Regulation**

**Legislation**
- No Leasing Law in Uganda
- Leasing transactions are based on Commercial and Common Law Principles

**Regulation**
- No regulation for independent lessors
- Leasing companies are registered under Companies Act
- Proposed FIS 2002 – Central Bank to regulate Finance leasing activities

**Taxation Laws**

**Classification of Finance Leases**
- S.60 of Income Tax Act 1997
- Lease term exceeds 75% of useful life
- Option to purchase end of lease term
- Estimated residual of less than 20%

**VAT Statute**
- Rentals subject to VAT of 17%
- Lessor claims VAT on purchases – (net funding)

**Accounting Treatment**
- 1st July 1997 Uganda adopted IAS
- Finance lease transactions
  - Lessee treated as owner of the equipment
  - Lessee claims capital allowance
  - Lessor taxed on interest earned

**Benefits of Leasing**

**For Lessees**
- Accessibility, especially to SME’s
- Minimal collateral - leased equipment
- Medium term 2-5 years
- Minimum initial capital outlay
- Easy of budgeting
- Rentals tailored to lessee cash flow
- Flexibility and process time
- Funds usage - effective credit delivery

**Macro Economic**
- Financial deepening
- Technology transfer/modernization
- Increased productivity
- Improved skills transfer
- Job creation for support services
- Improved health standards
- Increased access to banking/insurance systems

**Key features of Dfcu’s facilities**
- Size of facility: $ 2,000- $500,000.
- Lease currency: US$ or Ush match lessee income
- Lease period: 2 - 5 years
- Nature of equipment: any asset of a durable and identifiable nature (plant, equipment,machinery, commercial vehicles and business cars)
**Continue >>**

- Lessee contribution: 15-20% of equip. cost
- Ownership of the asset: lessor maintains full ownership throughout the lease period
- Option to purchase: exercised by lessee at end of the lease
- VAT: charged on rentals where applicable
- Insurance and maintenance: responsibility of lessee

**Challenges**

- Limited suitable funding sources.
- Asset monitoring & preservation
- Legislation and regulation
- Unfavorable tax environment
- Lack of leasing law – disputes
- Limited/non existent leasing skills
- High delivery costs – by the Banks
- Procurement hurdles

**Way forward**

- Conducive Leasing environment
- Responsive Financial Intermediaries
- Effective dispute resolution
- Capacity building
- Trade and Advisory services
- Supply chain linkages

**Conducive leasing environment**

- Tax Incentives
- Harmonization of tax laws in the region
- Light regulation – non deposit takers
- Engage policy makers
- Educate the market place
- Leasing Association – strong voice

**Responsive FIs**

- Fiscal incentives
- Credit enhancement – DFID Challenge Fund
- Leverage donor funding
- Enhance credit/leasing skills
- Invest in IT – Credit scoring etc.
- Suitable lines of credit
- Standardize, simplify process
- Operate profitably

**Effective dispute resolution**

- Strengthen the Commercial Courts: speed, capacity
- Promote the use of CADER services, train more arbitrators
Government/Donor support in capacity building

- Skills/technology transfer
- Research and product development
- Sustainable domestic consulting
- Support development of independent Associations
- Develop SMEs capacity to manage the environment on a sustainable basis

Trade and Advisory services

- Dissemination of market and trade information to SMEs
- Promote regular public/private dialogue
- Promote use of computers and access to internet

Supply chain linkages

- Nucleus firms (marketing, production)
- Outsourcing by large firms – core competence
- Training/skills transfer by large companies

THANK YOU
INTRODUCTION

- Principles of developing a scheme
- Case study of the process – Dairy sector in Kenya
- Lessor-driven scheme

Principles of a scheme

- Understand supply chains operating in the sub-sector
- Identify Net gain interventions
- Create or find an existing income stream
- Do market research
- Proofing the concept
- Final scheme operation

Understanding the supply chains in dairy

- End use markets
- Participants
- Processes
- Quantities (volumes, value added, numbers)
- Constraints & Opportunities
- Sub-sector Mapping
<table>
<thead>
<tr>
<th>Key Features</th>
<th>Identify Net-Gain Interventions</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Farmers receive Ksh. 5-12/ltr</td>
<td>• Reduce Waste, Losses</td>
</tr>
<tr>
<td>• Consumers pay Ksh. 48-50/ltr 24 hrs later</td>
<td>• Increase Production</td>
</tr>
<tr>
<td>• Per capita consumption below FAO levels</td>
<td>• Increase Ksh Market Size (total spending on milk) &lt;i&gt;not per capita consumption&lt;/i&gt;</td>
</tr>
<tr>
<td>• Marginal propensity to consume fresh milk</td>
<td></td>
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<tr>
<td>• Under-utilized processing capacity overall</td>
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<tr>
<td>• Most efforts focus on increasing production</td>
<td></td>
</tr>
<tr>
<td>• Data on $ size of market scanty</td>
<td></td>
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<tr>
<td>• Large waste of evening/flash period milk</td>
<td></td>
</tr>
<tr>
<td>• 80% of marketed milk sold loose</td>
<td></td>
</tr>
<tr>
<td>• Single use packaging @ Ksh. 7/ltr</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Identify possible net gain interventions</th>
<th>Identify an income or expenditure stream for lessee &amp; straddle it</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Milk chillers to save evening milk</td>
<td>• Loose milk dispenser has highest potential because it is at a bottleneck in supply chain.</td>
</tr>
<tr>
<td>• Motor bike with side cars to distribute dry ice</td>
<td>• Bundle lease installment with milk purchase</td>
</tr>
<tr>
<td>• Improve collection using motor bikes</td>
<td>• Stepped pricing – to maintain competitiveness of leveraging company</td>
</tr>
<tr>
<td>• Improve breeding using dewar flasks</td>
<td>• Plan for lease administration services</td>
</tr>
<tr>
<td>• Introduce Q/A bulk marketing through dispensers</td>
<td></td>
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<tr>
<td>• Introduce coolers to reduce in-shelf loses</td>
<td></td>
</tr>
<tr>
<td>• Bulk coolers &amp; bikes to reduce distribution costs</td>
<td></td>
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</tbody>
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<table>
<thead>
<tr>
<th>Market research</th>
<th></th>
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<tbody>
<tr>
<td>CHANGES INTRODUCE RISK</td>
<td></td>
</tr>
<tr>
<td>• Evaluate risk through a trial</td>
<td></td>
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<tr>
<td>• Gather information for lease structuring</td>
<td></td>
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<tr>
<td>• Improve lease scheme design</td>
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</tbody>
</table>
Proofing of the concept

- 20 dispensers in operation in one area
- Localised promotion of scheme
- Monitoring of technology, supply chain and market reaction.

Final scheme operation

- Large scale use of dispensers through many areas.
- Concept of dispensed milk accepted by market.
- Supply chain operates effectively to sustain leasing of dispensers.