



## Lease Finance in Nigeria: Current Status, Challenges and Future Prospects

U.F. Abdulkarim<sup>1\*</sup>, L. Mohammed<sup>2\*\*</sup>, A. Musa-Mubi<sup>3\*\*\*</sup>

<sup>1</sup>*Department of Accounting and Finance, Federal University Gusau, Zamfara State, Nigeria*

<sup>2,3</sup>*Department of Accounting, ABU Business School, Ahmadu Bello University, Zaria, Nigeria*

\*Corresponding Author: [elfarouk105@gmail.com](mailto:elfarouk105@gmail.com)

### Abstract

**Objective** – The Leasing industry in Nigeria is witnessing increased demand for assets under a given prevalence of rising domestic costs of purchase, shortage of foreign exchange for imports as well as persistent depreciation of the Naira. The objective of this paper is to analyze the current state of lease financing in Nigeria, the prospects and challenges with a view to assess the capacity of the industry to continue to provide this form of finance.

**Design/methodology** –The paper adopts an exploratory research design with references to publications, websites and research articles relevant to the subject matter. A number of relevant publications on leasing in Nigeria were duly explored.

**Results** – Our findings show that, the volume of lease finance has consistently grown over the last 14 years (2005-2018). Finance leases volume totaled 1.68 trillion naira in 2018 alone. Banks as market participants in the Nigerian lease industry finance other non-bank lessors while the non-bank lessors account for about 80% of lease transactions mostly to Micro, Small and Medium Scale Enterprises (MSMEs). Funding remains a major challenge restricting provision of leases to general supporting equipment and constraining leases of specialized assets (big-ticket leases). Prospects for lease finance obtain in terms of rising popularity of operating leases with lessors and lessees, attributable to the inherent mitigation against default risk. There is also potential for a growing customer base beyond MSMEs, with the influx of patronage by listed corporate firms especially those in the healthcare and education sectors. We identified financing partnerships, development of sound corporate governance practices, hastened inauguration of the Equipment Leasing Registration Authority and increased sensitization of potential leasehold product consumers on the benefits of lease finance, as critical success factors for the lease industry in Nigeria.

**Keywords:** Lease Finance, Lease Finance Prospects, Lease Finance Challenges.

### 1. Introduction

Economic activities are dependent on available and accessible resources, both financial and physical. Management decisions consequently revolve around sources and investment channels of finance in the course of ensuring optimum discharge of its primary responsibility to the stakeholders of an entity. There are various funding means which firms can subscribe to in the money and capital market institutions albeit, contingent on their nature (whether listed or unlisted) as well as the purpose and duration for which the finance is required (short, medium or long term). In a typical funding arrangement, liquid funds are made available to institutions for deployment to the purpose for which it was contracted- investments that would generate long term economic benefits to the firm.

There are non-traditional forms of finance that are targeted at providing access to and control of a tangible physical asset in place of funds (Kurfi, 2003). This is the premise of leases- contractual agreements between an asset-provider referred to as a lessor and the user-party, a lessee, who in exchange for control of an asset, makes payments over a defined period of time (Kraemer and Lang, 2012). Generally, there are two types of lease arrangements (finance and operating) which are distinguishable in terms of non-cancellation, near-synonymous duration of

lease term with asset life, payments leading to amortization of cost and generation of return as obtainable in a finance lease and the reverse, in case of an operating lease (Central Bank of Nigeria, 2014).

Based on the type of lease (finance), the lessee may be entitled to ownership at the expiration of the lease term if an interest in acquisition is indicated. Kurfi (2003) regards leases as “an alternative mode of financing to the traditional debt and equity for the acquisition of capital assets by firms”. Leases place emphasis on the lessor role in financing and making available an asset thus, eliminating a situation whereby the lessee would have to contract directly with a vendor or where cash-strapped, forego the use of such asset (Salam, 2013). In line with this thought, Fubara (2004) further notes the rationale behind leasing as reducing risks of asset ownership which could be in form of obsolescence, value fluctuation and disposal inefficiencies.

Globally, leasing is regarded as an efficient and effective source of finance for capital formation. Al- Qaisi (2018) traced the origin of leases to the 1950s in the United States, its extension to Japan and Europe in the 1960s and thereafter, developing countries. Leases are a suitable financing option where substantial capital outlay is required for assets as obtains in technology-intensive industries. During its period of needs for capital creation, Nigeria has had part of its economic development facilitated by leases as early as the 1960s, financing industries such as banking, aviation, oil and gas and manufacturing. Capital formation through lease contracts in Nigeria was valued at over 1.6 trillion naira between the years 2000 and 2014 while growth rate has also been consistently positive in the leasing industry between 2007 and 2015 though at varying increased and decreased levels inferred from year to year comparisons (Equipment Leasing Association of Nigeria, 2015). The rising number of lease contracts in recent times can be attributable to exorbitant asset costs and excess demand for foreign exchange due to currency depreciation that has constrained alternative imports (Federal Inland Revenue Service, 2010).

The Leasing industry in Nigeria has recorded a notable growth of 13.5 percent in 2019, with outstanding lease volume at N1.91trillion as against N1.68trillion in 2018. This growth can be attributed to numerous factors which include: the relative stability in the volatile macroeconomic environment, increasing demand for leasing services necessitated by the astronomical rising cost of assets; stimulation of domestic production; new entrants into the leasing industry and enhanced awareness on the ideals of leasing as a unique financing instrument (ELAN, 2019).

Further statistics on lease financing in Nigeria show that as at 2018, outstanding volume of lease transactions was 1.68 trillion naira to sectors inclusive of Oil and Gas, Transportation, Agriculture, Manufacturing, Government and Telecommunications among others (ELAN, 2018). Comparing Nigeria's performance with those of other countries around the world indicates that Nigeria is ranked as 46th on the list of top 50 countries using lease finance, contributing 0.51 billion dollars to the global lease volume in 2017 (White Clarke Group, 2019). Only three other African countries (South Africa, Morocco and Egypt) made the global rankings which are largely dominated by North American, European and Asian countries. With low representation of African countries, the implication is that there is still potential for substantial growth in terms of lease volume through identification and exploitation of opportunities to entrench leases as a main-stay source of finance in Africa and particularly in Nigeria.

Notwithstanding the need to expand the lease market in Nigeria, the body of extant corporate finance literature that focuses on lease finance remains somewhat narrow. The critical need to drive and expand the lease market in Nigeria can be exemplified by a statement issued by the Executive Secretary of ELAN, reported in The Guardian Newspaper (2017) which identifies government initiatives aimed at economic revitalization and infrastructural development, in addition to challenges

faced by Micro, Small and Medium scale enterprises (MSMEs) in accessing finance as impetus for the consideration of leases. This buttressed by the vast number of advantages associated, some of which include cash conservation, contracting ease and flexibility in matters concerning use and ownership of assets.

The objective of this paper therefore, is to analyze the current state of lease financing in Nigeria, prospects as well as challenges being faced which would inform a valid assessment of the continued capacity for the provision of this form of finance. The paper adopts an exploratory research design with references to publications, websites and research articles relevant to the subject matter. The remainder of the paper is divided into the following sections; section 2 provides a review of the lease industry in Nigeria including market participants, legislations and industry performance while section 3 reviews the prospect of lease finance industry in Nigeria. Section 4 provides an in-depth look into the challenges while section 5 provides requirements for sustainability of lease financing in Nigeria. Section 6 concludes the paper.

## **2. Lease Industry in Nigeria**

Backed by the ELAN (2015) which governs lease contracts in Nigeria, the Equipment Leasing Association of Nigeria (ELAN) and Finance Houses Association of Nigeria (FHAN) along with bank and non-bank lease companies are the key regulators and participants in the Nigerian lease industry. Lease finance as a source of national development and business financing has a long history in Nigeria. Oko and Anyanwu (2012) highlighted the role of leases in the post-civil war reconstruction activities of the government in the 1970s which demanded high-cost infrastructure. Therefore, the growth of the lease industry in Nigeria may not be attributable to the role of providers of lease finance alone but also the increase in economic activities as a result of the fiscal, monetary and economic policies. The Structural Adjustment Programme (SAP) of the 1980s which aggressively promoted commercialization and privatization of public institutions is notably one of such policies (Ndakotsu, 2000). Besides increase in costs of capital assets as a result of instability in foreign exchange rates, constraints on guaranteed off-shore loan facilitates in a bid to manage external debt burden over the years have underscored the importance and relevance of leases in Nigeria (Oko and Anyanwu, 2012). Furthermore, Oko and Essien (2014) noted that the lease industry in Nigeria is heterogeneous because transactions between principal parties- lessor and lessee depend on the nature of the lessee industry, purchasing capacity and propensity, firm size, mode of operation and management policies of the parties involved.

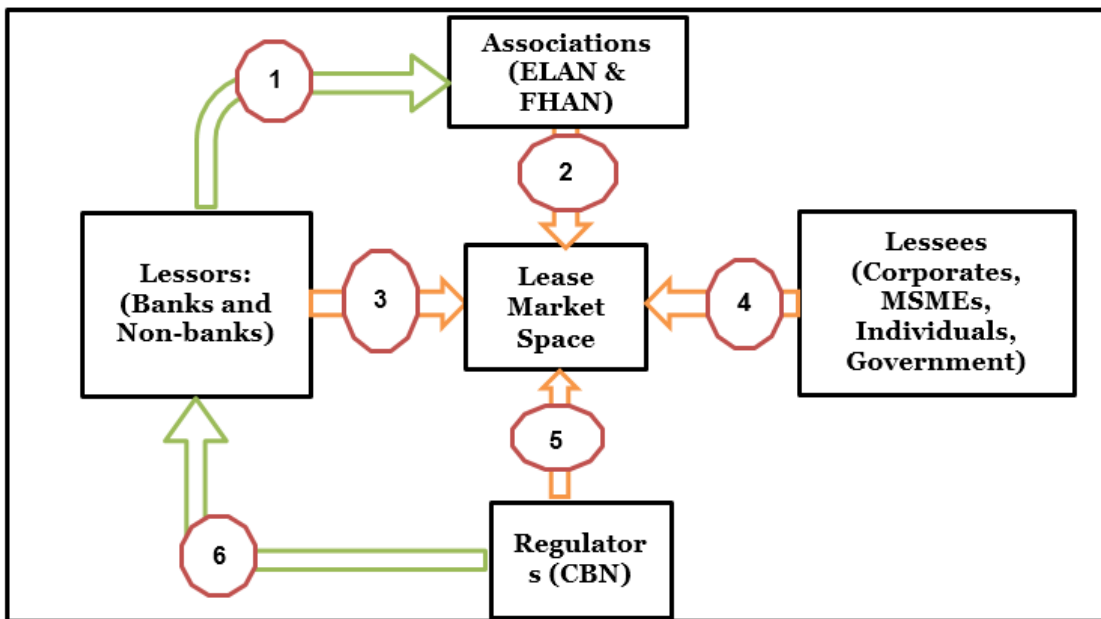
Lease finance is adopted for a diverse range of assets. Based on this, the market in Nigeria can be grouped into small, medium and large ticket lease transactions depending on the transaction size or value of assets leased (Alli, 2003). In 2018, vehicles were found to be the most leased assets accounting for 38%; plant and machinery, 14%; computers and office equipment also at 14%; aircraft/vessels accounted for 2% and others such as household equipment collectively constituted 10% of the total lease volume. The type of vehicles leased included trucks for haulage as well as buses for commercial inter-state transportation. Finance leases constituted 60% of total lease transactions as opposed to 40% for operating leases (ELAN, 2018). In analyzing the lease industry in Nigeria, discussion is made under the following sub-headings; market participants and dynamics, legislation and regulation, industry performance.

### *Market Participants and Dynamics*

There are four broad categories of market participants in the Nigerian lease industry which comprise regulators, associations, lessors and lessees. The regulators include the Central Bank of Nigeria which is the apex regulator of all banking and non-

banking financial transactions. The associations include the Equipment Leasing Association of Nigeria (ELAN) and Finance Houses Association of Nigeria (FHAN) that provide the platform and oversight for consummation of lease transactions. Oversight of the practice of lessors is vested in the ELAN, which is a business membership organization (BMO) established in 1983 to promote leasing activities and consisting in addition to banks, leasing companies, finance houses, insurance companies, professional firms and individual members. There are 325 lease financiers registered with ELAN as at 2017 spread across corporate, associate and individual membership (ELAN, 2017). Lessors are mostly banks that correspondingly finance other lessors (non-bank) in the leasing business. These non-bank lessors are however, noted to have wider outreach with credit for up to 80% of lease transactions and a target lessee market comprising mostly Micro, Small and Medium Scale Enterprises (MSMEs). The clientele of lessees is diverse and inclusive of individuals, MSMEs, corporate firms and government.

## Lease Finance Prospects, Lease Finance Challenges



**Figure 1.** Lease Market Dynamics in Nigeria<sup>1</sup>

Source: Authors' Depiction

The flow arrows represent the direction of activity flow while the numbered circles are activity flow label. Figure 1 depicts the typical Nigerian lease market dynamics and inter-play. The interplay shows the flow of the activities on the market, the actors (market participant(s)) that are responsible for initiating or carrying out that activity and the counter-party that is either the recipient being acted upon or the co-actor for that activity.

Activity Label	Market Actor	Activity Flow	Counter-party
1	Lessors		Associations
2	Associations		Lessor/Lessee
3	Lessors		Lessee
4	Lessees		Lessor
5	Regulators		Lessor/Lessee
6	Regulators		Lessor

Source: Authors' Depiction

**Table 1.** Lease Market Dynamics in Nigeria in a Tabular Form

<sup>1</sup>The flow arrows represents the direction of activity flow while the numbered circles are activity flow label

*Legislation and Regulation*

Prior to the signing into law of the Equipment Leasing Act on May 27, 2015, there was no specific legal framework governing the conduct of leasing activities in Nigeria. Hassan (2009) noted that reliance was based mainly on provisions in Common law, the Companies Income Tax Act (Companies Income Tax (Amendment) Act, 2007), Banks and Other Financial Institutions Act (Banks and Other Financial Institutions Act, 2004), the Companies and Allied Matters Act (as amended) and Accounting Standards for Leases. Banwo and Ighodalo (2015) cite the Equipment Leasing Act as poised to be the legal reference point for the execution of lease agreements. This is in consonance with general principles of Common Law and sections of the Companies Income Tax Act (as amended), Capital Gains Tax Act and Value Added Tax Act which affect leasing. The Equipment Leasing Act also provides for an Equipment Leasing Registration Authority for registration of companies as well as lease agreements.

In addition to the above, there exists a regulatory framework as per the Revised Guidelines for Finance Companies issued by the Central Bank of Nigeria (CBN) (Central Bank of Nigeria, 2014) whereby finance companies and leasing businesses outside the formal financial system, providing lease finance, are to be brought under the purview of the CBN through licensing and supervision. The regulation is to be with the collaboration of the Equipment Leasing Association of Nigeria (ELAN) as well as the Finance Houses Association of Nigeria (FHAN). The existence of a sound legal and regulatory framework has led to increased confidence and activity in lease contracting. This development is expected to be consolidated with set-up of the Equipment Leasing Registration Authority for public-private partnership (Equipment Leasing Association of Nigeria, 2019).

*Industry Performance*

The lease industry in Nigeria has a record of consistent growth in terms of actual volume and value of transactions. In 14 years, the market has grown by more than 10 folds. Table 1 shows the trend in the aggregate value of lease transactions consummated in Nigeria between the years 2005 and 2018.

**Table 2.** Leasing Industry Versus Nigeria's Economic Performance (2005-2018)

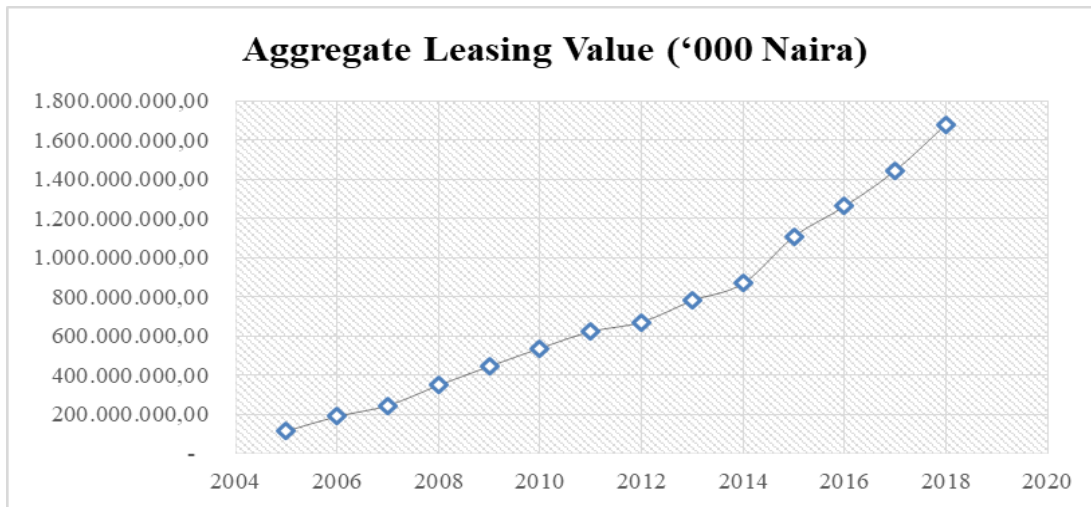
S/N	Year	Leasing Volume (₦)	Growth (%)	Marginal Growth (%)	GDP Growth
1	2005	115,140,079.01	46	0	6.44
2	2006	189,881,130.00	65	19	6.06
3	2007	245,700,000.00	30	-35	6.6
4	2008	348,894,000.00	42	12	6.76
5	2009	445,265,650.00	28	-14	8.04
6	2010	537,907,637.75	21	-7	8
7	2011	622,907,637.75	15.8	-5.2	5.31
8	2012	671,494,433.53	8	-7.8	4.23
9	2013	780,661,932.99	16	8	6.67
10	2014	869,017,875.10	11	-5	6.31
11	2015	1,107,041,794.67	27	16	2.65
12	2016	1,262,027,642.73	14	-13	-1.62
13	2017	1,445,021,651.11	14.5	0.5	0.81
14	2018	1,680,560,180.25	16.3	1.8	1.9

Source: Authors' compilation from ELAN Publications (2005- 2018)

From table 2, it can be seen that leasing volume has consistently increased between 2005 and 2018 from 115.14 billion naira to 1.68 trillion naira. This pattern is generally in tandem with the trajectory and general trend of the Nigerian economy

during same period. Figure 2 as follows, shows the trend of aggregate value of lease transactions in Nigeria from 2005 through to 2018.

### Lease Finance Prospects, Lease Finance Challenges

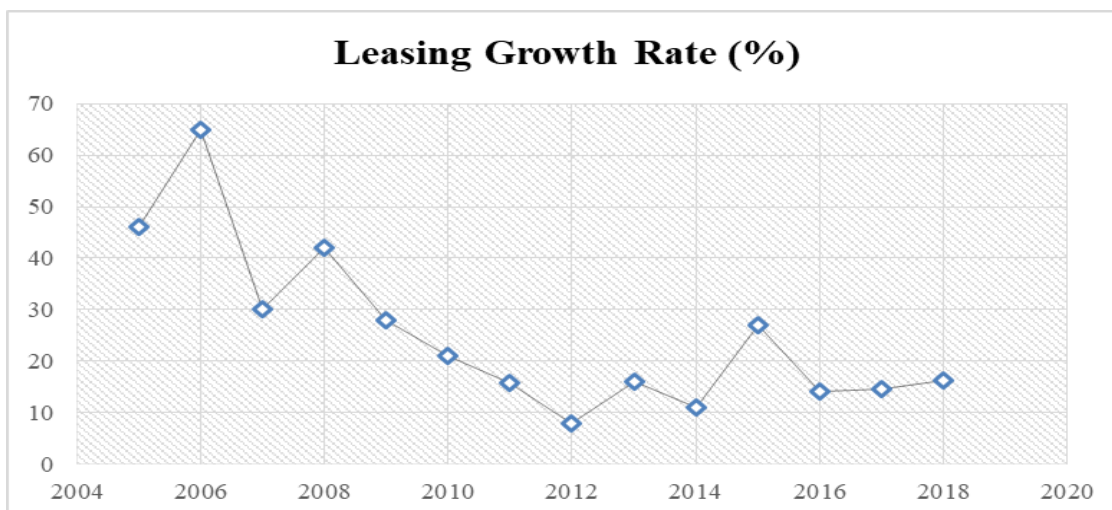


**Figure 2.** Aggregate Lease Value

Source: ELAN (2018)

The constant improvement in the aggregate lease value may not be unconnected to stabilization of the macro economy, increasing demand and growing participation in the leasing industry. Sectorial analysis of transactions in the industry during the period 2018, places the oil and gas sector in the lead with 518 billion naira (29%), transportation; 421 billion naira (28%) and manufacturing; 245 billion naira (12%). Agriculture, government, telecommunications, education, healthcare, and others account for the remainder. Leases tend to be on the increase due to demand boosted by multinational and corporate customers (ELAN, 2018).

Comparisons of lease industry growth in marginal terms from Table 2 show periods of decline (negative marginal growth rates) such as in 2007, 2009-2012, 2014 and 2016. In 2016, the industry witnessed a drop in growth to 14 % when compared with the 27% percent growth it recorded in 2015, attributable to excess demand for leases due to rising asset costs and funding inaccessibility of customers. The industry in general was adversely affected during the global economic meltdown of 2008 that properly took effect in 2009. Nigeria likewise, experienced an economic recession between 2016 and 2017 and from which the industry seems to be picking up albeit slowly with positive marginal growth rates of 0.5 and 1.8 in 2017 and 2018 respectively. The following Figures; 3, 4 and 5 depict the lease growth trend in absolute terms, marginal terms and in comparison with the GDP growth rate recorded by the Nigerian economy.



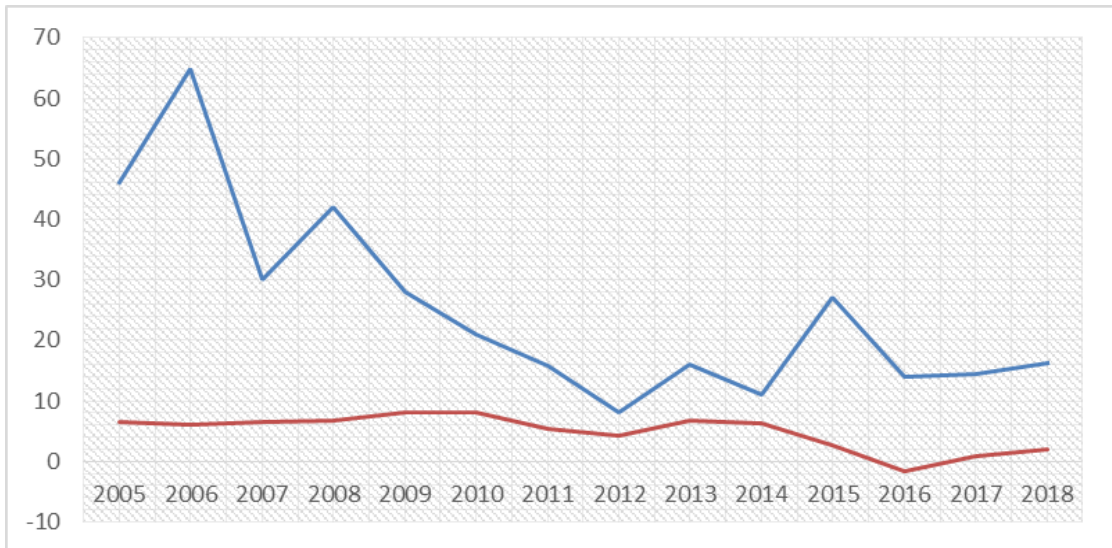
**Figure 3.** Lease Value Growth Trend

Source: ELAN (2018)



**Figure 4.** Lease Value Growth Trend

Source: ELAN (2018)



**Figure 5.** Lease Growth Rate versus GDP Growth Rate

Source: Authors' Depiction

### 3. Prospects of Lease Finance in Nigeria

There is rising popularity of operating lease finance with lessors and lessees attributable to the inherent mitigation against default risk as well as the demand by corporate firms for lease services. There is also potential for a growing customer base beyond MSMEs, with the influx of patronage by listed corporate firms who seek to avail themselves of finance opportunities besides those obtainable on the capital market. This may also be in light of positive effects that lease finance has on these firms as found by Bello et al., (2016) in examining the impact of leasing on profitability of listed oil and gas firms in Nigeria.

The agriculture, manufacturing and construction sectors of the economy are expected to sustain demand for specialized and general capital assets which by implication would translate to continued demand for lease finance. Emerging markets have also been identified in the healthcare and education sectors with ELAN exploring means of partnership with sector players in the provision of healthcare and instructional facilities (ELAN, 2017)

The prospects for lease finance are further accentuated in the 2019 Lease Outlook document published by ELAN which counts as enabling factors, huge financing gaps cutting across all sectors of the economy, constrained access to finance especially by MSMEs which makes leases to be attractive as a procurable source of finance and the suitability of leases as a means to the realization of Government initiatives towards economic recovery, growth and development. The lease industry is expected to develop secondary markets with innovation in its product offerings. Nwanyanwu (2015) recommends sophistication by lease businesses in service delivery through knowledge and deployment of Information and Communication Technology (ICT).

The introduction of the International Financial Reporting Standard (IFRS) 16 (2019) which guides the accounting for lease transactions is expected to have an effect on the nature of lease businesses. The accounting for operating leases in the prior International Accounting Standard (IAS) 17 which enabled the report of such finance off-balance sheet, was a prime reason for the attractiveness and subscription to operating lease finance as key performance and leverage ratios of lessee firms were favorably affected in the financial statements. With the replacement of IAS 17 and the current requirement for all leases irrespective of type to be recognized on the balance sheet, there is a foreseeable shift in the transaction structure of products provided by leasing businesses to that of service contracts. This would enable lessee firms to expense costs instead of capitalizing liabilities in their financial statements. The 2019 Outlook thus, forecasts sweeping changes to the lease business model, lease products offered and lease decisions taken by current and target lessees. Ingenuity on the part of lessors would be required to consolidate the place of leases as a finance alternative for capital formation in Nigeria.

#### **4. Challenges of Lease Finance in Nigeria**

The Nigerian lease industry is not without its challenges principal of which is funding for huge capital investments in order to meet current demand for lease products. The banks are adjudged to fall short of adequacy in financing capacity due to poor liquidity positions coupled with high lending rates. Correspondingly, the falling crude oil prices, rising asset prices and consequent devaluation of the naira is forecasted to increase the costs of leasing businesses necessitating innovative strategies for the survival and thrive of market participants (ELAN, 2015). In addition, the volatile exchange rate discourages the sourcing of funds by lessors from foreign markets leading to potentially high financing cost for both lessors and lessees.

The consequence of this funding dilemma that lessors face has been the restriction of lease service provision to general supporting equipment and MSMEs. Participation in the big-ticket leases which involve provision of specialized assets therefore, remains low. Furthermore, leasing as a key source of financing growth in firms does not enjoy the level of publicity that finance products such as term loan, time loan and overdraft enjoy. As a result, many businesses do not consider it as a valuable option for financing the acquisition of assets for their businesses. This, in spite of the fact that collateralization has always been a general problem in the Nigerian financial sector. Most businesses that currently enjoy lease facilities being MSMEs typically lack collateral assets. In big-ticket lease transactions, lessors struggle due to funding inadequacies to perfect the lease asset in time for consummation leading to either failed transaction or unnecessary delay in completion.

#### **5. Requirements for Sustainability of Lease Finance in Nigeria**

The 2019 Outlook document posits that the inauguration of the Equipment Leasing Registration Authority will enable effective enforcement of the provisions of the Equipment Leasing Act (2015), which in turn, will provide a sound legal frame work for operations, attractive to local and foreign investors in the Leasing industry.



There is also the need to raise level of awareness across all stakeholders in the economy (individuals, households, firms and government) of leasing as a finance alternative. This corroborates the recommendation of Musa-Mubi (2017) based on findings of lease use to be negatively and significantly affected by other forms of debt constituting leverage in listed non-financial firms in Nigeria. Orientation of target clients is geared towards increasing patronage and the domino effect of instituting enhanced capacity to meet demand in the provision of lease finance by lessors.

Leasing businesses as well as the Equipment Leasing Association of Nigeria (ELAN) need to amplify efforts in disseminating information on the benefits and processes involved in leasing. This can be achieved through marketing strategies, conduct of conferences, seminars, publications, direct and indirect engagements with prospective customers. Sustained capacity building and market research is necessary on the part of lessors to ensure their viability through being acquainted with consumer needs, market trends, risk, legal and regulatory dynamics amongst others.

A Communique of the Business Forum organized by ELAN (2017) points out the potential of insurance and pension funds as important sources of finance for the lease industry given its funding shortages. It stressed the need for collaboration between the insurance and lease industries whereby insurance companies increase their investments in leasing businesses as well as provide residual risk insurance cover for leased assets. The Communique further recommended the institution of effective corporate governance in leasing businesses in order to enhance reputation (similarly, credit ratings) and facilitate access to funding. It would be of immense benefit to lessors if the Government enables access to not just pension funds but the various interventions finance allocated to different sectors of the economy.

## 6. Conclusion

A strong statement can be made for the development of the capacity of lease financing in Nigeria given the presence of necessitating and enabling factors. The importance of capital assets as instruments towards optimum functioning at all levels among individual, household, firm and government, and the constraints to access especially due to cost, underscore the potential for leases as a convenient and flexible means of asset acquisition. Given a secured environment in terms of legal and regulatory frameworks that address needs and concerns of both lessors and lessees, the intensified efforts at raising awareness, the impending partnership towards adequate lessor funding as well as emerging markets identified in sectors such as healthcare, education, agriculture and infrastructure, lease finance is on course to becoming a prevalent finance option in Nigeria.

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