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Determinants of Lease Financing Decisions among Insurance Companies in Kenya

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Abstract

Purpose: *The purpose of the study was to establish the determinants of lease financing decisions among insurance firms in Kenya. The study sought to establish the important factors that are considered by firms in making leasing decisions.*

Methodology: *The research adopted a census survey on all the 46 insurance firms registered in Kenya. Descriptive statistics was used in summarizing and analyzing the data.*

Findings: *The findings revealed that, the majority of respondents consider leasing as an important and essential alternative to borrowing. This means that insurance companies evaluate the cost of leasing assets relative to cost of borrowing as is suggested in finance theory. It was also clear from the findings that the most leased asset were financial lease as opposed to operating lease by insurance companies and that the most leased assets were land and building.*

Implication: *The study concluded that four factors are essential to leasing decision namely: tax rate policy, cost of borrowing, financial constraints and legal framework and other factors as largely very important to essential in leasing decisions as , nature of the assets, liquidity, and agency cost, lease information availability, profitability, accounting policies, financial distress, total debt ratio and availability of financial resources, hence there is a significant relationship between determinants of leasing and lease financing in firms in the insurance industry.*

Value: *This study extends knowledge to theory building in financing specifically in lease financing by companies to enhance their services by embarking on marketing their services, creating awareness and building a sound legal framework to motivate many firms in making lease decisions.*

Key words*: Financial leases, operating leases, lease financing, insurance companies*

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1.1 Introduction

Leasing as a means of financing tangible assets has made a significant contribution to capital formation across the globe. This alternative source of financing has made it possible for firms to generally own fixed assets without necessarily buying. Many organizations today have the opportunity not only to obtain the use of services and equipment through buying them, but have an alternative to lease them. The ability of companies to access finance is becoming an uphill task in the changing business environment. Choice of source of financing is important in ensuring businesses reach their expansion prospective, and for facilitating new business start-ups; a lack of funds can hinder cash flow and slow down businesses' continued existence prospects (BIS, 2012).In a competitive environment, it is always advisable for managers to make superior selection of capital composition that can maximize the wealth of the shareholders. Lease or buy is typically a financing decision which is based on the current and future availability of cash (Bauman 1990). This decision becomes very simple if the corporate borrower has extended its line of credit to the limit, as borrowing costs then become, excessive and may involve a shareholder giving personal pledge. Leasing in such circumstances is much more attractive regardless of the tax implications alternatively, if the company can arrange the required borrowing with an acceptable finance cost, the buy lease decisions become more difficult. It is from this argument that the current study sought to establish other factors that firms need to consider when making leasing decisions.

The choice to lease or buy has been supported by a number of theories namely; financial contracting, The MM theorem and pecking order. Financial contracting theory for instant, has traditionally, focused on the tax advantages as the principal rational objective for leasing (Hart, Oliver and Holmstrom 1987). MM-theorem's main argument is on the existence of perfect capital markets devoid of taxes implications, transaction costs, bankruptcy costs, information asymmetries and agency costs facilitating fluid access to finance by entities (Modigliani and Miller 1958, Brealey and Myers, 2008). And pecking order theory is focusing more on agency costs, where leasing may be resorted to by firms to reduce the cost (Myers, 1984; Myers & Majluf, 1984). For the current study given a number of determinants to lease financing, financial contracting theory, pecking order theory and Modigliani-Miller theorem (1958) will be used in

explaining how the determinants of firms capital structure may influence leasing decisions, since firms may have different reasons to use leasing as an alternative or substitute to debt financing.

The insurance industry has undergone tremendous growth with 2017 Full Year Gross Premiums topping KES 207.68Bn,a 6.6% growth from KES 174.74Bn and a five year Compounded Annual Growth Rate (CAGR) of 10.0%. This has led to many insurance firms identifying Africa as a lucrative continent full of growth opportunities. Insurance companies in Kenya are hoping for a rebound after posting a cumulative 18 per cent decline in profitability in 2017, marking a difficult year for the industry. In an indication of how tough the environment was for Kenya's insurance sector, profits dropped to $118.2 million from $144.8 million in 2016. The decline is attributed to banks' interest rate capping, which continues to have a spiral effect because a slowdown in lending has affected investments in projects and assets. The 2018 annual premium reported by the long term insurers amounted to KES 87.34 billion, growing by 5.3% from KES 82.97 billion reported in quarter four of 2017. The long term insurers' asset base grew by 10.9% to KES 392.32 billion and largely composed of income generating investments to the tune of KES 355.26 billion. Of the total assets, 11.8% (KES 46.25 billion) was funded through shareholders' equity. Given other alternative source of financing Kenya has recently recorded a colossal growth in the leasing of business fixed assets (Ombija, 2007). The obvious explanation for this progression is the advantage to the lessee being able to use general fixed assets without having to buy. Researchers are still indifference whether leasing or borrowing decision is a complicated decision for the firm to make. It is argued that the development of leasing goes hand in hand with the development of the financial sector. Insurance industry need to look for lease financing is now .There have been notable developments in the financial sector which can be a source of capital for lessors and working capital for lessees. The Insurance Act has undergone various revisions in 2017 (The Insurance Act 2017). Changes related largely to harmonizing the risk-based capital provisions within the Act and the creation of perpetual licenses for insurance companies. The amendments have resulted in additional deduction to the capital available putting strain on Adequacy Ratio for most underwriters. This limits internal ability to raise capital cushion to cover risk held. This has forced the regulator to review the priority in the industry with the need to have well capitalized, stable and secure industry.

1.1.1 Lease Financing Decision

Lease financing can be defined under two perspectives; one 'economic perspective' and two, 'accounting perspective'. Under the economic perspective, lease financing decision is defined as the asset based financing through which two parties enter into a contract or have to agree to the contract, to provide an asset for use by other interested parties over a particular moment in time, and in return for specific payments (Fletcher et al. (2005). Under accounting perspective, lease financing is defined as asset based financing through which two parties agree to the contract, where the provider of the asset retains ownership of the assets leased over the course of the life of the contract (IAS 17, 1999, p.440). However, in a more refined way, leasing financing is a contract whereby two parties make an arrangement in which one party uses an asset and in return for a payment or series of payments to the lessor over a period of time (IAS 17, 3). The leased assets are regarded as an inherent form of collateral during the contracts period.

Leasing can be categorized under three broad classes; sale and lease back, direct leasing or leverage leasing (Munene 2014). Or alternatively we can discuss them under two major classes - operating or financial/ capital leases (IAS 17). The major distinction between the two classes of leases is in terms of reward, periodic payment, ownership and economic life associated with the asset.

Collender and Morehart, (2004) noted that leasing can be treated as a right to the use of the substantial assets over specified conditions. This further confirms leasing as a standardized contract in accounting and finance. Brage (2009) describes two major methods for measuring leasing decisions among firms. The two methods are; volume and access. Leasing is measured in terms of capacity/ volume by identifying the total value of all new leasing contract signed under certain period and leasing penetration or access by identifying the proportion of all fixed long lived assets in plant and equipment in relation to other assets.

1.1.2 Determinants of Lease Financing

Determinant of lease financing involves examining factors that influence the use of leasing as an alternative form of financing (Yan, 2006). Globally various scholars have identified different

determinants to lease financing based on the advantages of lease financing (Lasfer 2007; Morais 2013; Nair 2010 and Mungami 2013).

Previous studies propose a number of determinants to lease financing based on various stages of growth and future prospects. Determinants manifests in different forms. Based on the works of Smith and Wakeman's (1985), identified firm size, industry, nature of assets, ownership structure and market imperfection as major determinants. More contemporary empirical studies have identified various determinants of lease financing (Lasfer (2007); Al-shaib and Bawnih 2008; Morais 2013). However, other scholars argue that lease financing should be treated as substitute to medium to long term credit, and as a complement to debt financing (Severin and Filareto-Deghaye, 2007).

1.2 Research Problem

Lease financing is a peculiar asset-based form of debt financing resulting in the acquisition of a physical noncurrent asset instead of liquid cash (Kraemer-Eis & Lang, 2012). It is used as one of the sources of capital or financing. However, the issue of determinants to lease financing decision has had controversy among researchers. The overall results of studies on determinants have mixed results. Globally, researchers' examine leases as either an alternative form of financing or as a complement to debt financing (Morais 2013; Beattie et al. 2000; Yan, 2006 and Deloof et al. 2007; Essien 2013). This further complicates what really determines the use of leases among firms, but scholars agree there could be some factors driving firms to use leasing as a source of financing. Morais (2013) established that lease finance is used more predominant in some special firms than others, despite the high growth rates and the benefits of it as an alternative source of financing, there are still factors which suppress the further development of lease financing such as regulations, trusts and market imperfections (Wardrop et al. (2015, Pinotti (2012). Therefore, the nature of the relationship among the determinants of lease as an alternative source of finance still remains a debate today among scholars.

Few studies are available in the insurance industry though, having a close link in the aim of explaining lease finance in firms, vary significantly on the basis of methodology and coverage. Thus various studies related to lease financing in quoted manufacturing industries, SMEs and

non-financial firms (Akinbola and Otokiti, 2012 and Oko and Anyanwu 2012) have only tried to link leasing decision majorly to the scarcity of financial resources to acquire equipment for usage, imperfect markets and financial distress. Only a few studies have specifically link leasing decisions to various determinants in the industrial set-ups (Mungami 2013; Morais 2013 and Salam Al-Shaib and Bawnih 2008) .These studies have failed to look at lease as an alternative source of finance among established companies but simply treated as a source of financing under companies under distress. The research seeks to achieve the following objectives:

i. To establish the determinants of lease financing decision among insurance companies in Kenya.
ii. To determine the relationship between firm size and lease type among insurance companies in Kenya.
iii. To determine if lease financing is used as a substitute of debt among the insurance companies in Kenya.

The study is based on this three theories; financial contracting theory, Modigliani–Miller theorem and pecking order theory.

2.1 Literature Review

In the literature of finance, the impetus for leasing is well supported by the capital structure theories considering certain attributes and determinants of firm's capital decisions. Lease financing is currently common among many firms due to different reasons thus the choice to lease or own assets is only just a matter of triviality to firms. The impetus of the current study is to ascertain why leasing would be a preferred source of finance among firms. A number of theories have been advanced to explain why capital structure of firms matter. The following theories will be used to underpin the study; financial contracting theory, Modigliani–Miller theorem and pecking order theory.

The financial contracting theory is founded largely on thoughts of the economics principles as advanced by Hart, Oliver and Holmstrom (1987). The theory states that firms that need external financing needs to also have better financial information than their financiers on factors that affect the extent to which they honor their commitments. This theory further advocates that firm characteristics, business opportunities, risk exposures and the character of the asset may impact

on contracting costs and thus the preference to lease not to buy asset rest with individual firms (Good Acre, 2003). Thus leasing decision is a way of alleviating financial distress because the asset is purchased by the lesser and hence the working capital of the company remains high to sustain other activities.

Debt irrelevant theorem was proposed by Modigliani-Miller (1958). Their main argument was on the existence of perfect capital markets devoid of taxes, transaction costs, bankruptcy costs, information asymmetries and agency costs facilitating fluid access to finance by entities. This theorem forms part of the corporate modern philosophy going on the structure of an ideal financial arrangement. The model is grounded on certain market conditions and in the nonexistence of such assumptions, the value of a firm is unaffected by how that firm is financed. Therefore, the theorem can often be referred to as 'the capital structure irrelevance principle' (Brealey and Myers, 2008). An implication of the Modigliani–Miller theorem to the current study assumes that the normal value capitalize on agents that have perfect and symmetric information on leasing decisions. The theorem makes two fundamental contributions, formal uses of a no arbitrage argument, which forms the debate on why irrelevance fails around the theorem's assumptions. And secondly is on the impact of taxation and its validity. It is assumed that taxation policy is used by many firms to realign the capital structure.

The theory pecking order theory was founded in 1984 by works of Myers and Majluf. This theory is built on the principle of a financing hierarchy by firms in order to minimize the value of the firm against the backdrop of information symmetry between the stakeholders. Many of the firms have not yet, used pecking order approach in ranking leasing as one of the sources of capital available for the firm. As a debt like instrument, leasing is expected to be ranked by firms. Myers and Majluf (2006) asserted that capital structures of firms is built around information availability on sources of finances and this causes firms to follow a pecking order approach to financing their investments. Their arguments imply that firms will choose the cheapest source of financing before debt and equity as a last resort. This only becomes practical in the absence of lease financing. In the context of the pecking order theory (Myers, 1984; Myers & Majluf, 1984), where information asymmetry abounds, higher costs of capital may prevail due to the consideration of risk (Cortez & Susanto, 2012).

In light of this, finance leases may therefore be a last resort alternative source of financing for many firms in the modern economy. The implication of the theory to the current study is that, information asymmetries force firms to follow a pecking order approach to financing, hence the use leasing as an alternative source of financing may hold. Olabisi-Ekpudu and Dafe (2013) assert that pecking order theory is only applicable to profitable businesses that which can resort to fund their operations by use of debt and retained earnings; hence non profitable firms may resort to leasing as an alternative source of financing.

The debate among scholars has been whether lease financing may be categorized as an alternative source of financing to other sources of financing such as equity and debt. Empirical literature indicates mixed results on categorization of leasing as one of the types of financing used in acquiring capital equipment. In financial studies, one cannot say with certainty that leasing and debts are substitutes or even compliments. However, leasing is often considered as an alternative to medium or long term credit (Elgers & Clark, 2010).

Beattie et al. (2000) and Deloof et al. (2007) conducted a study to establish the degree to which lease financing can be used as substitute to debt. The finding revealed that leases can be used as a substitute to debt rather than a complements to each other. However, Eisfeldt and Rampini (2008) look at lease financing as a compliment to debt due to its benefits. The benefit of using lease financing accrues to the lessors in getting back the leased assets. The finding was that leases can be used as a complement to debt when leading rates are high.

Tsay (2003) argues that due to the relationship between earnings and residual value of the firm, companies tend to go for lease financing, if the association proves to be negative. However, the opposite should also apply when both firm earning and residual value remains positive, then the firms ought to rent out the assets. Under this condition then, lease financing will be treated as complements to debt. From the two aspects empirical review indicates that there is no consensus on how leasing should be classified given that each firm is unique to capital structure adopted (Imhoff, Robert and David, 2004). The use of lease and debt may depend on a number of factors may influence the choice of lease.

A number of studies have identified determinants of lease financing decisions. However, there are mixed results on why firms use lease financing since different firms have different objectives on why they use lease financing. Morais (2013) identified determinants of lease financing as majorly the characteristics of firms in relation to debt. The determinants entails firm size, tax opportunities, nature of properties, financial restrictions and organization reward as major factors affecting both lease and debt. Salam Al-Shaib and Bawnih (2008) who established determinants of leasing as tax, accounting, legal, marketing as the major determinants of leasing specifically in industrial companies. Eis and Lang (2012) who identified a single determinant of lease financing as market imperfection in the small medium enterprise. Fortin and Landry (2011) demonstrated that the higher the marginal tax rate of the firm, the lower its degree of leasing. And that any tax reform would affect lease financing decision.

There are many studies that have been carried out in the field of leasing. Nyachieng"a (2010) did a study to identify the determinants of financing lease related contacts among small as well as medium enterprises in Kenya. Fatma (2012) tried to identify factors that influenced the strategies that medium-sized companies used to lease assets in Kenya. All these studies concentrated on small medium enterprises leaving out well developed firms.

Olabisi, Ekpudu and Dafe, (2014) established that the advantage of borrowing is only in the tax advantage. Essien, (2013), noted that lessee companies' exhibit higher levels of tax recoverable significantly than non-lessee firms. However, empirical research done by other researchers found that companies tend to lease out more of the assets whose purpose is more general in nature. Gavazza (2010) indicates that the liquidity of leased assets have a greater impact on the lease decision. Thus the more liquid the assets the higher chances a company would prefer the use of leasing decision. Akinbola and Otokiti (2012) in their study indicated that leasing has lots of benefits to the continued existence, expansion opportunities and profitability of companies. The finding shows that management compensation, accounting measures and accounting policies as the determinants of lease financing.

Duke et al. (2002) in their study noted from the study finding that management incentive is not one of the determinants to lease financing. However, Robicheaux and Fu (2008) contradict the result; the companies that have comprehensive incentive for the management are more prone to go for lease financing as an alternative in order to ease organization overheads.

Many studies consider profitability as a major determinant of lease decision. Sabastine and Kolawole, (2013) suggest that profitability may be regarded as a determinant to lease decision. Salam Al- shiab and Bawnih (2008) established in their study that tax, accounting, legal and marketing variables as major determinants of leasing in industrial companies in Jordan.

Eis and Lang (2012) in their study among small medium enterprises concluded that leasing is an integral part of finance and that, it's an alternative financing to bank loans and overdrafts for SME and that most SMEs use it under market imperfections. Morais (2013) argues that scholars have not come to the agreement on when to use debt or leases as either a complements or a substitutes. He further, established that determinants to lease financing will vary from one firm to another. Their finding was categorical that lease financing is more predominant in some industries than others.

Mungami (2013) analyzed the effect of company's specific factors on leasing decision. The study used Mann-Whitney test, Pearson correlation and logit model to determine the effect of determinants of leasing decisions. The conclusion was that cost of capital, financial distress, size, share ownership, management compensation, total debt ratio, chief executive share ownership was the most important determinants for capital leasing decision. However, this study singled out that financial distress and leverage were not as important as other factors to firms making leasing decision.

Muumbi (2014) sought to establish how lease financing may impact on the financial performance of listed companies at NSE. The study adopted panel data in establishing the impact. The findings were that companies divert the money that could be used for making purchases of equipment to the working capital or investments. The findings further revealed that lease financing has a positive relationship with return on assets (ROA) and return on equity (ROE). Li,

Karim and Munir (2016) reported both positive and negative relationship on determinants and lease decisions both under operating and capital lease. Ownership, tax policy, financial distress and firm size had a positive relationship with operating lease but negative relationship with debt ratio, profitability and nature of the assets. The study further established that capital lease increases with debt ratio, profitability, firm size and corporate governance but decreases with ownership and financial distress.

Munga and Ayuma (2015) conducted a study among public institutions in Kenya on the usage of lease financing. They used stratified random samplings and structured questionnaires. Their findings were that availability of financial resource and agency cost had inverse influence on the use of lease financing and cost reduction. They further concluded that cost of borrowing had a positive influence on the use of lease financing in the public institutions. The study further recommended that public institutions should adopt lease financing in obtaining properties and equipment like office, machines and vehicles.

Mutune (2016) evaluated the use of leasing as an asset financing strategy by investment companies listed at NSE. The findings revealed that leasing services are valuable to organizations and were mostly used in ICT, finance, human resource and administration departments. The study was basically conducted to identify the benefits and challenges of lease financing to the various sector or companies listed in NSE. Obiero (2016) conducted a study to determine the effect of lease financing on monetary performance of corporations registered at NSE. The research adopted descriptive design. The result was that lease financing and liquidity has independent variable affected return on asset (ROA) positively, whereas using the volume of the firm and leverage had a negative effect on return on asset (ROA).

Naim (2008) conducted a study in Tanzania and identified four factors as essential in the provision of leasing services. The factors ranges from - excellent financial management skills, access to diversified sources of local currency financing, excellent governance and performance management framework and a sustainable competitive niche. His finding was based on data from Small medium enterprises.

3.1 Methodology of Research

We adopted a descriptive research design in identifying the most essential determinants to lease decisions. The target population included all the registered 48 insurance companies in Kenya and regulated by Insurance regulatory authority as at December 2018. We further used primary data to collect information from these insurance companies. Structured questionnaires were used in data collection, which were in-form of both closed ended and open ended types. The study further used descriptive statistics to analyze data and classify the factors as essential, very important and important. The study used mean, mode, frequency, percentages and standard deviation in the analysis. The mode was preferred because most of the data were ordinal scale.

4.1 Study Findings, Conclusion and Recommendations

4.1.1 Leasing Type

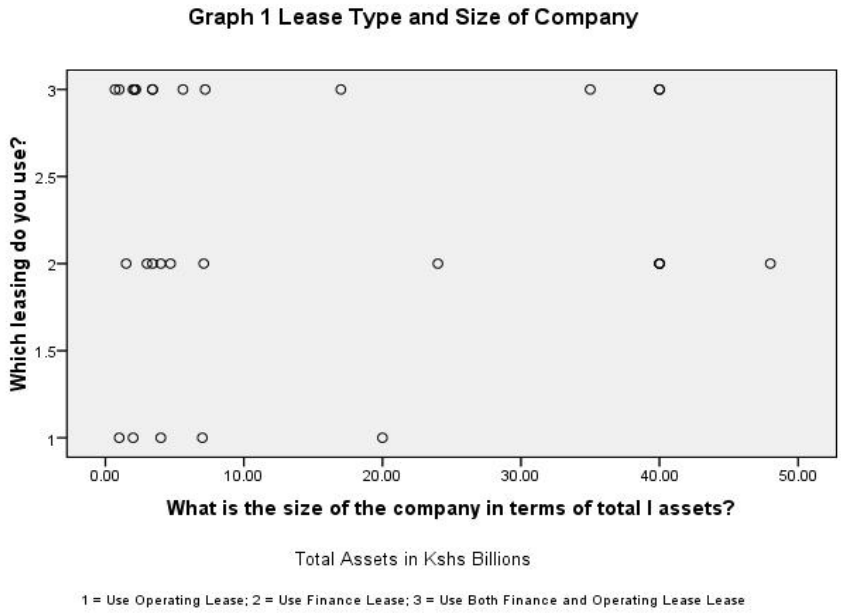
The researchers sought to establish the types of leasing taken and their relationships. The results of the lease type by sampled companies are presented in Table 1 and Figure 1. Table 1 has summarized the lease type across the insurance firms while figure 1 shows the relationship between lease type and the size of the insurance company.

Table 1: Lease Type

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Finance Lease	5	16.1	16.1	16.1
	Operating Lease	11	35.5	35.5	51.6
	Both	15	48.4	48.4	100.0
	Total	31	100.0	100.0	

The findings show that the most popular lease type is operating lease (36%). This means most insurance companies prefer lease that provides for both financing and maintenance, this is in addition to any lease pact in black and white for a considerable shorter than expected life of the leased assets, with a cancellation clause. Only 16% of the respondents indicated that they use finance lease. However, 48% of respondents use both operating and finance lease. Financial

lease has one major benefit of only covering the entire expected life of the equipment; but does not provide for maintenances service and hence, irrecoverable. This findings therefore confirms the empirical works of Imhoff, Robert and David (2004) who noted that there is no consensus on how leasing should be classified given that each firm is unique to capital structure adopted.



4.1.2 Relationship between the size of the Firm and Operating Lease

The results of the analysis indicate that the frequency use of operating lease, taking into account asset size is presented in Table 2; and the results show that only two firms with average asset size of Shs 5.60 never used operating lease, but ten firms with average asset size of Shs 20.6 rarely used operating lease.

Table 2: the size of the Company and Use Operating Lease

How often does your company use operating lease as financing option?	Mean	N	Std. Deviation
Never	5.6000	2	2.263
Rarely	20.6100	10	19.716
Sometimes	11.2941	17	13.951
Total	14.1138	29	16.168

The researchers further sought to examine whether there exist any relationship between the size of the firm and frequency of using operating lease. The results in Table 3 indicate that there is no linear relationship between the size of the company and frequency of use of operating lease.

Table 3: ANOVA - The Size of the Company and use Operating Lease

			Sum of Squares	df	Mean Square	F	Sig.
What is the size of the company in terms of total assets? * How often does your company use operating lease as financing option?	Between Groups	(Combined)	702.136	2	351.068	1.379	.270
		Linearity	84.975	1	84.975	.334	.568
		Deviation from Linearity	617.161	1	617.161	2.425	.132
	Within Groups		6617.45	26	254.518		
	Total		7319.59	28			

The p-value of 0.568 is greater than the cut off value of 0.05, the r square is low 0.012 and Eta squared of 0.096 confirm absences of linear relationship. The same results apply in the case of tests for linear relationships between firm size and use of the finance lease as presented in Table 4. Financial analyses require that the cost of leasing is compared with the cost of debt to enable the potential lessee select cheapest cost of capital. The respondents were asked how important leasing is used as an alternative to borrowing (debt); that is, will it is cheaper borrowing and using the proceeds from borrowing to buy the asset or will the insurance company be better off leasing? The majority of respondents consider leasing as an important and essential alternative to borrowing that is 48% of respondents consider it very important while 35.5% consider it essential. This means that insurance companies evaluate the cost of leasing assets relative to cost of borrowing as is suggested in finance theory. The research findings are in line with Elgers & Clark (2010) who found that leasing is often considered as an alternative to medium or long term credit. Conversely, in financial studies, one cannot say with certainty that leasing and debts are substitutes or even compliments.

Table 4: ANOVA - The Size of the Company and Use Finance Lease

			Sum of Squares	Df	Mean Square	F	Sig.
What is the size of the company in terms of total assets? * How often does your company use finance lease as financing option?	Between Groups	(Combined)	1910.103	2	955.052	4.590	.020
		Linearity	125.074	1	125.074	.601	.445
		Deviation from Linearity	1785.030	1	1785.030	8.580	.007
	Within Groups		5409.491	26	208.057		
	Total		7319.594	28			

The study further sought to identify the most finance – capital leased assets among the insurance firms. From the analysis result, the most leased asset as a financial lease by insurance companies is land and building, with a mode of three (fairly many times). The low standard deviation, which is less than one, shows that respondents agree that this is the most leased asset.

The frequencies in Table 5 show that 77.4% (38.7+38.7) percent of the respondents lease land and building as a capital lease. The interpretation is that, it is possible that owners of land and building prefer leasing than selling, and this makes it difficult borrowing and buying assets.

Table 5: Frequency – Capital (Finance) Lease

	Never %	Occasionally %	Fairly many times %	Very often always %	Total %
How often do you lease Land and building as capital lease?	9.7	12.9	38.7	38.7	100.0
How often do you lease Plant and machinery as capital lease?	35.5	29.0	19.4	16.1	100.0
How often do you lease Office equipment as capital lease?	38.7	9.7	25.8	25.8	100.0
How often do you lease Computer equipment as capital lease?	54.8	12.9	29.0	3.2	100.0
How often do you lease Vehicles as capital lease?	29.0	38.7	25.8	6.5	100.0

The study findings further revealed that, the least leased asset is computer equipment, with 54.8% respondents saying, they have never leased this class of an asset as a capital lease. The interpretation is that, it appears these assets are bought because their cost relative to other assets is low. It is in practice that the office equipment is sometimes leased and sometimes bought. So insurance companies might lease equipment rather than buying to reduce the risk associated with ownership, for example, operating flexibility and risk of obsoleteness. Hence, a financial lease is wholly amortized and normally does not embrace maintenance requirements. A financial lease would highly be used for a manufacturing plant and other fixed equipment's which insurance companies may hope to buy.

4.1.3 Operating Lease - Asset Class

The study further sought to identify the most leased operating lease asset classes by asking how often they are leased. The analysis results of operating lease types are presented in Table 6 and 7.

Table 6: Operating Lease – Asset classes

	Median	Mode	Std. Deviation
How often do you lease Land and building as operating lease?	3	3	1.078
How often do you lease Plant and machinery as operating lease?	2	1	1.110
How often do you lease Office equipment as operating lease?	2	1	1.154
How often do you lease Computer equipment as operating lease?	1	1	0.893
How often do you lease Vehicles as operating lease?	2	1a	0.944

Key 1 = Never; 2 = Occasionally; 3 = Fairly Many Times and 4 = Very Often Always

Table 7: Frequency - Operating Lease – Asset Classes

	Never	Occasionally	Fairly many times	Very often always	Total
	%	%	%	%	%
How often do you lease Land and building as operating lease?	19.4	9.7	41.9	29.0	100
How often do you lease Plant and machinery as operating lease?	48.4	19.4	19.4	12.9	100
How often do you lease Office equipment as operating lease?	38.7	12.9	32.3	16.1	100
How often do you lease Computer equipment as operating lease?	54.8	16.1	29.0		100
How often do you lease Vehicles as operating lease?	32.3	32.3	29.0	6.5	100

The most leased asset under operating lease is land and building, but the standard deviation of more than one (1.078) suggest lacking of agreement between the respondents. The mode for the remaining assets suggests the low use of operating lease (see table 7). It is apparent insurance firms buy rather than lease computer hardware; and are not worried about obsolescence. Thus insurance companies have preference over operating lease to capital lease. The findings are indeed in agreement with other similar empirical studies such as (Munami 2013; Eis and Lang (2012); Marias 2013 and Gavazza 2010). An operating lease is typically revocable but includes maintenance requirements. This makes this type of financing to be applicable or frequently, for a shorter period of time than the economic life of the asset, this makes the lessor not too often

recover his/her full investment during the period of the basic lease, hence , majorly applicable for a fleet of trucks.

4.1.4 Factors considered in Leasing Decision

The findings revealed that, majority of respondents consider leasing as an important and essential alternative to borrowing. This means that insurance companies evaluate the cost of leasing assets relative to cost of borrowing as is suggested in finance theory. It was also clear from the findings that the most leased asset were financial lease as opposed to operating lease by insurance companies and that the most leased assets were land and building.

Table 8: Frequency - Factors considered when making leasing decision

	Not important	Some what important	Very important	Essential	Total
	%	%	%	%	%
1. How important is Tax rate policy as a factor in your lease decisions?	9.68	3.23	25.81	61.29	100
2. How important is Cost of borrowing as a factor in your lease decisions?	0.00	3.23	38.71	58.06	100
3. How important is Financial constraints / restrictions as a factors in your lease decisions?	0.00	0.00	40.00	60.00	100
4. How important is Legal framework as a factor in your lease decisions?	9.68	6.45	32.26	51.61	100
5. How important is Nature of the Assets as a factor in your lease decisions?	3.33	3.33	50.00	43.33	100
6. How important is Liquidity as a factor in your lease decisions?	0.00	0.00	61.29	38.71	100
7. How important is Agency cost as a factor in your lease decisions?	0.00	6.45	64.52	29.03	100
8. How important is Lease information availability as a factor in your lease decisions?	3.23	3.23	54.84	38.71	100

	Not important	Some what important	Very important	Essential	Total
9. How important is Profitability of the firm as a factor in your lease decisions?	9.68	3.23	64.52	22.58	100
10. How important is Business size as a factor in your lease decisions?	3.23	16.13	41.94	38.71	100
11. How important is Management compensation as factors in your lease decisions?	10.00	20.00	43.33	26.67	100
12. How important is Organization rewards as factors in your lease decisions?	12.90	29.03	38.71	19.35	100
13. How important is Accounting policies / measures as a factors in your lease decisions?	12.90	6.45	64.52	16.13	100
14. How important is financial distress as a factor in your lease decisions?	0.00	6.45	67.74	25.81	100
15. How important is Share ownership as a factor in your lease decisions?	9.68	19.35	45.16	25.81	100
16. How important is Total debt ratio as a factor in your lease decisions?	9.68	12.90	51.61	25.81	100
17. How important is Availability of financial resources as a factor in your lease decisions?	3.23	0.00	51.61	45.16	100

4.1.5 Discussion of Findings

The study generally found out that there are a number of factors that were found to be either essential for lease decisions among insurance companies. The study categorized the seventeen factors as essential, very important and important. None of the seventeen factors was regarded as less important. However, the study did not categorize lease decisions as either operating or capital lease.

On the relationship between size of the company and lease type it was clear there was no linear relationship between the size of the firm and frequency of using both finance and operating lease

type. Most of the firms interviewed reported that the use of operating lease however, depended with the asset size but there was no was statistical significant relationship.

The analysis was also conducted to determine if insurance companies use lease financing as a substitute to debt. Financial analyses require that the cost of leasing is compared with the cost of debt to enable the potential lessee select cheapest cost of capital. The overall percentage (83.5%) indicated that majority of the insurance companies consider leasing as an alternative to borrowing but not a substitute to debt.

On the most capital leased assets by insurance companies were land and buildings (77.4%). This meant that there is more preference in leasing than buying or building. The findings further reported that the most leased operating lease were also land and buildings however, standard deviation of more than one indicate lack of agreement among the respondents (1.078).

The findings are in agreement with empirical studies(Munga and Ayuma 2015; Matume 2016 ;Salam- Al- Shiab and Bawnih 2008), who identified tax rate, legal framework, cost of borrowing as the most essential factors in making leasing decision. Specifically, Salam –Al-shaib and Bawnih (2008) found out that one of the key factors, which promote leasing in any country, is a transparent and effective legal framework, which clearly regulate the relationships between the parties to a lease.

Tax is another essential factor because the full amount of the lease payment is a tax-deductible expense to the lessee. Therefore, a lease contract must be in a form acceptable to Kenya Revenue Authority. Some respondents (9.68%) consider tax not important; this will be the case for the firms in non-tax paying position. Tax is only beneficial to profitable firms in tax paying position. The finance literature identifies tax oriented and non-tax oriented lease. This study finding conforms to empirical studies such as Yan (2002) and Uwe (2008) says that the purpose of companies leasing equipment and not to buy is due to taxes and that most significant difference between leasing and buying equipment is in the manner in which both are treated as regards income tax. A business with high-income tax might decide not to lease equipment based on its inability to bring forth economic advantage. The findings are therefore interpreted to mean that

the financial solutions that can give rise to higher tax benefits are used. This can be further supported by Landry, Fortin and Callimaci (2013 and Callimaci. Fortin and Landry (2011) who demonstrate that the higher the marginal tax rate of the firm, the lower its degree of leasing. However, a study done by Chen, Chi, Lobo and Yong (2018) contradicts the finding, saying that there is very little influence on tax rate and debt capacity in lease decision.

As expected liquidity is a critical factor because companies unable to raise cash for outright purchase would prefer lease. Lease is used by companies that are low in cash flows, particularly young firms. This is because, in a lease main initial cash expense may well be limited to leasing deposit, and later regular lease rent. The finding is interpreted to mean that leasing has its effects on the cash flows of firms. The results are in agreement with Kilpatrick and Nancy (2007) and Gavazza (2010) that leasing highly depend of a firm's cash-flows. The more liquid the assets the higher chances the insurance companies would prefer the use of lease decisions.

Accounting policies are considered very important (mode 3) because disclosing information about leasing is costly. Furthermore operating leases are not capitalized, therefore not considered for calculating return on assets (ROA). Managers that want to enhance ROI would rather opt for operating lease instead of outright purchase. It is possible that neither leased assets nor lease related liabilities appear directly on the insurance company's balance sheet; what accountants refer to as off balance sheet financing. Therefore, in addition to magnifying ROA, the finance lease leaves the debt ratio deceptively low. In this respect, leasing has a negative financial statement effect that hides the true financial position of a firm.

Profitability is an important factor (mode 3) because profitable firms are able to service lease obligations. Organization reward is considered not important by 12.9% of respondents and very important by 38.71% suggesting that respondents do not see a relationship between leasing and organization rewards. The finding confirms exactly what other empirical studies reported, Duke et al. (2002) that management incentive is not one of the determinants, however, contradicts the works of Robicheaux and Fu (2008); Mungami (2013) who reported that comprehensive management incentives would highly influence the lease decision by firms. Debt ratio is considered very important and essential by 80.42% (51.61+28.81) of the respondents. This

suggests that insurance companies look at the level of borrowing. The study findings are in agreement with those of Mungami (2013), Deloof et al. (2007) suggesting that firms would go for leasing depending on the level of debt ratio. The implication is that leasing can be used as a substitute to debt rather than a complement to debt.

Financial distress is a very important factor to leasing (67.4% of respondents) because it increases the likelihood of low cash flows. Firms with low cash flows are more likely to lease than buy assets. Financial distress can result into bankruptcy. Thus leasing can be a substitute for debt finance because both of them reduce debt capacity. However, given the fact that lessors have first claim on the asset leased, leasing is likely to be advantageous for financially distressed companies.

The other very important factor is agency cost as presented in Table 14, and this is explained in terms of managers making financial decisions, such as leasing, independent of shareholders preferences. The finding is in agreement to Li, Karim and Munir (2016) who classified lease decisions under operating and capital and found out that capital lease increases with debt ratio and firm size but decreases with financial distress. However, under operating lease their findings also reports positive relationship with financial distress. Contemporary companies characterized by a separation between ownership and control are likely to suffer from the free cash flow problem where managers undertake negative NPV projects. Given that leasing is not an investment decision and lessors have first claim over the asset, it can reduce the agency conflict. Empirical studies (Smith and Wakeman 1985) suggest that firms are unlikely to lease assets that are highly specific to the organization; otherwise bilateral monopoly problem would create agency conflicts between the lessor and the lessee. In fact most of the studies predict that leasing is more likely to occur if the value of the asset is not specialized to the firm. Thus insurance companies are likely to lease generic office equipment than more firm-specific facilities.

The study concluded that four factors are essential to leasing decision namely: tax rate policy, cost of borrowing, financial constraints and legal framework and other factors that were also considered as largely very important to essential in leasing decisions were , nature of the assets, liquidity, and agency cost, lease information availability, profitability, accounting policies,

financial distress, total debt ratio and availability of financial resources, hence there is a significant relationship between determinants of leasing and lease financing in firms in the insurance industry. This study therefore recommends leasing companies to enhance their services by embarking on marketing their services, creating awareness and building a sound legal framework to motivate many firms in making lease decisions.

This study dwelt mostly on the factors that influence lease decisions; the researcher could not go further than identification of the factors. Hence, other Research should therefore be done to establish the effect of each factor on lease decisions and compliance to lease financing framework. A further research should be done to establish and clearly define the mode of classification of leases into its various types. From the study and related conclusions, the researcher recommends further research in the area of the effects of lease financing determinants on the financial performance of firms in the insurance industry. The study also recommends further studies on the effects of determinants of lease financing on the working capital of firms in the insurance industry.

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