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Potential for Leasing Products: Asset Financing for Micro- & Small Businesses in Tanzania and Uganda

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LIST OF ACRONYMS

ANED	-	Asociacion Nacional Ecumenica de Desarrollo
ASCA	-	Accumulating Savings and Co-operative Association
CERUDEB	-	Centenary Rural Development Bank
DFCU	-	Development Finance Company of Uganda
EADB	-	East African Development Bank
IFC	-	International Finance Corporation
KTU	-	Kenya, Tanzania, Uganda Leasing Company
MEDA	-	Mennonite Enterprise Development Association
MFI	-	Microfinance Institution
MIS	-	Management Information System
MSE	-	Micro Small Enterprises
NLC	-	Network Leasing Corporation of Pakistan
PTF	-	Presidential Trust Fund
RoSCA	-	Rotating Savings and Credit Association
SDC	-	Swiss Agency for Development Co-operation
SIDO	-	Small Industrial Development Organisation
SUFFICE	-	Support To Feasible Financial Institutions and Capacity Building Efforts
ULC	-	United Leasing Company
UMU	-	Uganda Microfinance Union
UNIDO	-	United Nations Industrial Development Organisation
UWFT	-	Uganda Women Finance Trust Ltd.
VAT	-	Value Added Tax
YOSEFO	-	Youth Self Employment Foundation Organisation

Kukopesha	-	Swahili word for lending
Kukodisha	-	Swahili word for operating lease – asset rental for business use
Kupangisa	-	Luganda word for renting assets for business use

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Executive Summary

Background

The most frequently cited constraints to micro- and small enterprise development concern the lack of access to appropriate and usable financing. Entrepreneurs in the micro- and small enterprise (MSE) sector requiring asset finance are frequently caught in a “missing middle” between products available from microfinance institutions (MFIs) and those available from formal sector institutions.

Informal financing arrangements are common. These include borrowing from friends and relatives, reinvesting profits, reciprocal usage arrangements, informal operating leases, and borrowing from moneylenders. However, even this multitude of informal sector possibilities remains insufficient to meet the demand.

This study explores the potential for the development of products specifically targeted towards asset finance in the MSE sector in East Africa. The study used a combination of in-depth interviews with key actors from MFIs, leasing companies, and commercial banks, and focus group discussions with entrepreneurs to examine both demand and supply issues. Specially modified Participatory Rapid Appraisal (PRA) tools were used to understand client perceptions of existing and potential leasing products.

Structure of the Study

Included in this study is an examination of the demand for and supply of leasing services in East Africa. Provided is an overview of formal sector leasing with an explanation of the legal and tax advantages of leasing for formal sector businesses. The myriad of informal and semi-formal mechanisms used by micro- and small entrepreneurs to finance their assets is listed. These financing sources far exceed the financing provided to small and micro-entrepreneurs by formal sector enterprises.

Leasing products are examined in detail, including lease amounts, terms, degrees of flexibility, grace periods and interest rates. Other costs such as insurance, deposits, collateral, and requirements for guarantors have all been considered. Integrated in the analysis are the processes surrounding the leasing product including: selection criteria, speed of processing, appraisal, approval, selection of asset, mode of disbursement, follow up and collection, payment incentives and repossession.

Options are considered for viable lending to this sector for leasing companies, MFIs and conventional banks in turn. The case for creating strategic relationships between leasing companies and MFIs or business associations is disputed and found to be a poor choice.

The study concludes by examining the role of donors. Options considered include: bringing lenders and borrowers together, funding technical assistance to reduce new industry risks and capitalisation through providing time limited guarantee funds and/or loans from which lessors can on-lend.

Findings

Demand and Supply Issues

There is a large unmet demand for leasing among MSEs seeking medium term (2-3 years) financing ranging from approximately $1,500 to $100,000. Most micro-entrepreneurs require less than $1,500, which is at the high end of currently available MFI loans. With as many MFI clients that already use working capital loans to finance assets, MFIs should recognise the demand asset financing and develop appropriate asset finance products.

The study reflects a preference amongst lessees and leaser for finance leases - Whilst micro and small entrepreneurs demonstrate an overwhelming desire to own the assets they use in their businesses, there are sectors where informal operating lease arrangements are widely used, especially where the entrepreneur cannot use an asset to its full capacity or is not able to purchase outright. However, finance leases, which confer ownership, are far more popular than operating leases, which do not. Operating leases are not attractive to lessors as they involve a large investment in terms of institutional infrastructure like warehouses to hold assets and maintenance departments to maintain assets misused by lessees.

The market for asset financing among micro-, small and medium enterprises is segmented, creating opportunities for different players to serve particular market niches. Enterprises in the trade and service sector are mainly micro-enterprises and require financing for lower cost assets such as sewing machines, refrigerators, freezers, carpentry tools, etc.; whilst those in the transport, construction, health and education sectors are small to medium sized and use assets with greater financing requirements. This suggests that institutions can implement programmes that target specific market segments on the basis of their asset financing requirements, with MFIs being uniquely equipped to serve the micro-enterprises and leasing companies the upper market segment. The "missing middle" could be serviced either through partnership arrangements between MFIs and leasing companies, or through specialised leasing institutions established specifically to serve this segment of the potential client community.

Leasing companies can extend asset financing to enterprises whose needs exceed the lending caps of MFIs. To do this, MFI clients would continue to access working capital loans from MFIs while seeking asset financing from leasing companies. To serve these clients, leasing companies need to simplify their risk management and loan approval systems in an effort to reduce costs. Strategies include placing greater reliance on non-traditional collateral, and using rapid loan appraisal techniques using local knowledge –such as MFI credit history, trade associations, etc. Strong follow-up systems that would be required could be provided by strategic partnerships between the MFIs with their field presence and leasing companies with their strong monitoring systems.

Product/Concept Refinement

Most small enterprise operators were very positive about the typical leasing product. They tend to prefer a product with a low initial deposit of 2-5%, a grace period of 1-4 months, and flexible repayment schedules that are responsive to variations in cash flow.

Minimal collateral, in the form of the asset itself, has often been cited as one of the attractions to leasing. However, in the East African markets, leasors routinely require large deposits ranging from 15-30% of the value of the asset in addition to the asset and other collateral, compared to 1-4% elsewhere in the world. Many upper end micro- and small enterprises feel that this large deposit is not only difficult to raise but that it ties up working capital, which can no longer be pledged as security for working capital credit.

The effective interest rate of leasing companies is frequently much higher than that of conventional banks. Although nominal interest rates are comparable to those of banks, large deposit requirements (15-30%) combined with transaction fees increase effective interest to a level sometimes equivalent to interest rates charged by East Africa MFIs.

Institutional Issues and Strategic Considerations

Leasing is a specialised asset financing service **-** any institution wishing to establish a leasing business needs to adopt an appropriate, operational and institutional structure to accommodate leasing activities. The institution has to consider which sectors to target, operational requirements, staffing, financing and liquidity requirements, management information systems, taxation implications and the regulatory environment. Collectively, these issues determine the company's strategic direction. Some banks – for example Stanbic Bank in Tanzania - have established leasing subsidiaries to enable clients to deduct the entire principle and interest on the loan for taxation purposes. In Uganda, some banks are considering a leasing subsidiary to take advantage of the VAT exemption.

Financial institutions considering leasing to the small enterprise sector in the East African markets need to conduct systematic market research and pilot testing in order to identify demand and supply issues. Institutions need to establish which business sectors, and geographic areas have a demand for particular types of asset and also develop efficient appraisal and monitoring processes.

This study suggests that MFIs should initially recommend their clients with bigger asset financing needs to a leasing company that specialises in dealing with the issues that are unique to leasing. Leasing, like individual lending, requires a different set of skills from the group lending methodology familiar to most MFIs, as well as the consideration of legal, taxation and technical issues necessary to establish a viable leasing operation.

Policy Considerations

Uganda, like Tanzania, should consider adopting the global practice of considering full rentals as tax deductible and lessor claims depreciation on the assets. Thus, leasing companies would be able to offer the lessee better terms. Most small enterprises make low profits and are not able to take advantage of the depreciation tax benefits due them under the current taxation system. A policy change is recommended to enable the lessors to claim depreciation and pass on this benefit to their lessees in the form of lower charges.

The Ministry of Finance in Uganda indicated that this is an area they are observing and will be ready to discuss if sufficient evidence is made available indicating that lessees are unable to take advantage of the depreciation benefits.

Policy makers and regulators should not rush to regulate because it may stifle innovation as the sector seeks to establish itself. Several players in the leasing industry in Uganda and Tanzania have expressed a fear of pre-mature regulation from central authorities. Mark Havers of the Springfield Centre put it aptly when he said, "If a leasing company is not taking deposits, then there is no more reason for it to be regulated than for a biscuit maker to be regulated. If it takes deposits, then something much more like banking supervision is likely to be required."

Donor Contribution

Lack of medium and long term financing is one of the biggest hindrances to the development of leasing especially because most financial institutions and investors are focusing on "safer" short-term investments especially Treasury Bills. Donors could fill this gap by making medium and long term loans to leasing companies, providing loan guarantees to reduce the perceived risk and/or participating in equity guarantee funds. Donors could improve the chances of such programmes success by financing the training of technical expertise and campaigns for Leasing-Awareness, as well as lobbying for an enabling policy and regulatory environment.

However, extreme caution should be exercised in designing and promoting guarantee funds because of the extensive global experience with failed attempts. Guarantee Funds are difficult to establish and are subject to protracted negotiations. They often present difficulties with respect to donors' internal accounting practices, typically relating to contingent liabilities, providing cash in advance of need and in the recognition of fee income. Guarantee funds need to be carefully designed to minimise moral hazard, e.g. when a company undertakes nonviable lending, or does not properly pursue defaulters – knowing that loan default can be recovered through a guarantee.

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1.0 Introduction And Background

1.1 Objective of the Study

This purpose of this study was to assess the potential market for profitable and client responsive micro-leasing products. This study strived to understand the desires, needs and capacities of low-income households and businesses in order to determine the potential market for micro-leasing and the form micro-leasing products may take.

The specific research objectives were:

1) To understand how micro- and small enterprise operators obtain money to purchase household and business assets in both the formal and informal sectors.
2) To categorise the types of assets leased by financial value, industry or sub-sector and portability.
3) To evaluate the financial products, systems, methods and rules of selected Tanzanian and Ugandan MFIs from the perspective of clients who have used them to finance business assets. Institutions involved included UMU, MEDA, PTF, PRIDE and YOSEFU. (See Appendix D for details)
4) To identify informal and semi-formal leasing products and assessing how well they fulfil the asset financing requirements of business operators.
5) To assess the products, systems, methods and rules of various leasing companies and asset financing companies in Tanzania and Uganda primarily from a client perspective. The Tanzanian based leasing companies involved in the study included United Leasing Company (500 clients with average $50,000) and Selfina Ltd (800 micro-clients, $700 average lease). Interviews were conducted with SIDO, a national government program previously involved in equipment financing but is now is looking at transforming itself and focusing on other activities. In Uganda the leasing companies included Development Finance Company of Uganda (DFCU) Leasing and the East African Development Bank (EADB)[1]. Other companies contacted in Uganda included Diamond Trust Leasing – which has closed its leasing operations. The team, in spite of the numerous attempts, was an able to meet any one from KTU (Kenya, Tanzania, Uganda) Leasing, which appears to be a one-man business. Therefore the last two companies do not feature in the report.
6) To assess clients' likes, dislikes and their suggestions for improving existing leasing products.
7) To assess the nature of demand for leasing products for micro and small businesses.
8) To obtain an overview of the regulatory environment of the leasing industry. Unfortunately, the researchers were unsuccessful in obtaining sufficient information from the de-regulation project team housed in the Ministry of Finance in Uganda. The experience was the same in Tanzania.

1.2 Methods

The research was carried out using the following tools:

1) **Individual in-depth interviews** with:
    - management of leasing and asset financing companies to establish their opinions regarding the potential for leasing to micro and small enterprises;
    - current lessees to obtain their opinions regarding their current asset financing options; and
    - potential lessees to establish their asset financing needs, their perceptions of the formal financing mechanisms with which they are familiar and the attributes of an asset financing product for which they are willing to pay.
2) **Focus group discussions** with:

[1] While EADB is headquartered in Kampala, Uganda, it leases assets to business operators in the three East African countries.

- current lessees to establish their perceptions of the current asset financing arrangements as well as ideas of how they can be improved; and
- MFI clients to assess their perceptions of MFIs as an asset financing option as well as their recommendations concerning product design for an asset-financing product.

3) **Product Attribute Ranking** (a participatory rapid appraisal technique) with current lessees to establish which elements of the leasing concept and product they liked most, which product attributes they did not like and the areas where products should change.

4) **Financial Sector Trend Analysis** (a participatory rapid appraisal technique) with potential lessees to establish why they will use some asset financing mechanisms and not others, thus establishing what motivates client choices for asset financing.

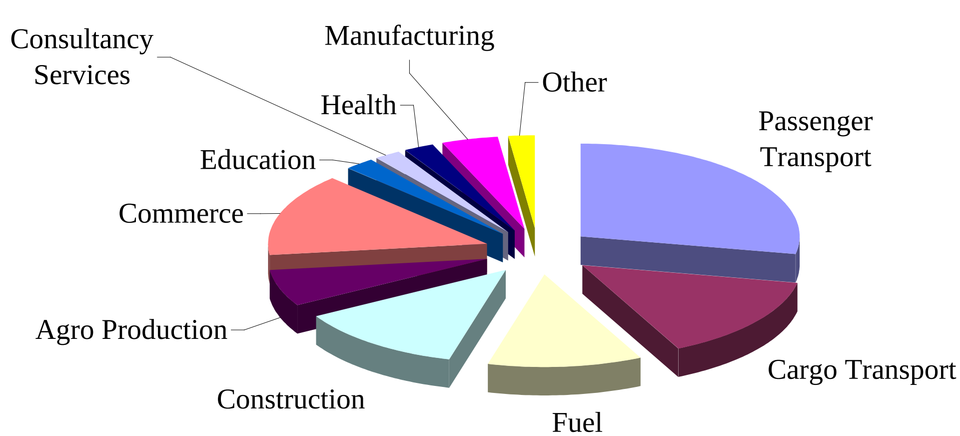
2.0 Demand For MSE Asset Financing By Enterprise Sector

Like many other developing economies, access to financial services still remains one of the key bottlenecks in Uganda and Tanzania's enterprise sectors. Commercial banks focus on larger corporate clients and salaried employees. MFIs focus largely on the economically active poor. However, micro-, small and medium sized businesses are the main pillars of both Uganda and Tanzania's economies. Over three quarters of registered businesses are small-scale (with 5-20 staff). Cumulatively, micro-, small and medium-scale enterprises account for around 97% of the total enterprises and for half the employment in the private sector (Sander, 2000) Still, despite their obvious economic importance, micro- and small enterprises (MSEs) frequently find themselves in a gap in the market, appropriately termed "The Missing Middle".

Lessors in Uganda and Tanzania have distinct preferences for businesses:

1) that are cash rich and generate a regular income flow;
2) who needs non-specialized assets with a ready secondary market allowing sale of reposed assets;
3) whose assets are multi-purpose can be used across sectors; and
4) whose assets have clear titles of ownership for ease of repossession and liquidation.

Box 1: DFCU Leasing Portfolio By Sector, December 2001



Transport is the dominant sector in Ugandan and Tanzanian leasing companies' portfolios that concentrate on the small and medium size business with very little provision for the micro-enterprises. As of December 2000, DFCU leasing had 58% of its Ush.20.5 billion (approximately US$12.5 million) worth of leases and approvals in the transport sector. Demand is driven by the multi-sectoral nature of transport, which cuts across manufacturing, education, construction, tourism, etc. Box 1 illustrates that passenger transport accounts for the largest portion of the DFCU portfolio (27%), followed by cargo transport (14%). Transport in the tourism sector accounts for a larger proportion of the United Leasing Company (ULC) portfolio, which is otherwise similar to that of DFCU.

The education sector in Uganda is an attractive market for leasing products because it is growing exponentially, a growth driven by the country's demographic structure as more than 50% of the population is below the age of 15 years. An increasing number of privately owned schools need a range of assets including computers and information technology, buses, etc. More critically, the Ministry of Education introduced a new policy requiring all schools to use buses to transport pupils, rather than using trucks, as was the previous practice. DFCU has noted that there has been an increase in the demand for buses, a number of which have been leased from DFCU.

In both Uganda and Tanzania, the information technology (IT) sector offers good potential for leasing products spurred by the global IT expansion. This trend is particularly evident in Tanzania where there is a proliferation of internet cafés, with a café on almost every street in Dar-es-Salaam. Many of these cafés have financed their assets through lease financing. IT experts and internet café operators saw huge potential for growth especially in schools, e-mail correspondence and e-commerce; though the latter has been limited because it requires credit cards which have moderate penetration in both countries.

Also, in communications there have been interesting developments with organisations like FINCA Uganda and OLP (Pakistan) developing relationships with cellular telephone providers. Celtel (Uganda) and Voice Tel Tech (Pakistan), provide a package that enables the buyer to set up as a Public Communication Centre (PCO) providing telephone, e-mail and fax services. Whilst the FINCA/Celtel relationship in Uganda has just started, OLP leases significant numbers of these units. Mark Havers and Mary Margaret Nansubuga[2] report that compared to other leases, the leasing company can reduce the intensity and hence the cost of appraisal because they work with companies that know the business model and readily cut-off a lessee who fails to make their repayments.

The trade and services sector mainly requires small ticket items that can be purchased using MFI financing. However, many small and medium enterprises in this sector have little access to financing.

Sectors such as textile, tailoring and carpentry, are adversely affected by cheap imports of a similar or higher quality than the products made locally. This limits these micro-entrepreneurs' ability to finance capital assets and thus reduces the opportunities available to them for expanding their businesses such that they may become more competitive. Businesses demanding asset financing tend to have high utilisation of assets, which can justify the cost of ownership. However, other businesses, particularly in the construction and carpentry sector use certain assets rarely so that the cost of ownership becomes more expensive than renting the asset each time the asset is needed.

Leasing companies and banks in East Africa are reluctant to lend to the agricultural sector even in agrarian economies due to perceived high lending risks. Mike Magney, managing director of Magric (U) Ltd explained that because of poor equipment maintenance and relatively cheap local labour, most lessors are reluctant to finance tractors and related farm machinery for the modernisation of agriculture. The comparison to more developed economies is stark - in Bolivia, for example, 94.64% of ANED's leasing activities have financed the productive agriculture sector, 53.2% of total volume of contracts financed farm tractors increasing the availability of machinery in the areas worked and offering constant services for agricultural activities there (Dupleich, 2000).

Table 1 presents a limited list of assets used or owned by the various business operators interviewed. Assets are categorised based on their value and the sector in which they are used. It is important to keep in mind that the value of similar assets might vary significantly based on the capacity, features, manufacturer, and

[2] Mary Margaret Nansubuga is in charge of the programme at FINCA Uganda

whether they are new or re-conditioned. The table also provides a rough indication of where respondents felt there was potential for future growth and need for asset financing.

Table 1. Business Assets and Sector-by-Sector Potential for Asset Financing

Sector	**Micro-Business (less than$2,500)**	**Small Business ($2,500 – $50,000)**	**Comments on Potential Asset Financing**
Retail Trade And Service	Refrigerators, freezers, shelves, weighing scales, sewing machines, sofa sets for events	Freezers, refrigerators, weighing scales	This sector's rapid growth is propelled by the availability of working capital loans from MFIs
Food Processing	Juice bars – juicing machines, fridges/coolers, Honey farms-hives, honey harvesting gear Dairy - milk coolers, cream containers, pasturisers, filling machines, milk separators, mobile milk units, etc.	Milk vans, milk processing plants, canning equipment, bottling equipment, generators, coolers, water bottling equipment	Growing urban populations with changing tastes plus increasing number of graduates from newly established institute of food technology could fuel growth in this sector.
Information Technology	Computers and printers for secretarial services – fax machines, photocopiers	Computers, generators, UPS Units, satellite dishes, printers especially for internet cafes	High potential especially for schools, education and e-mail communication and at a later stage e-commerce. Tanzania, especially Dar-es-Salaam has a high density of Internet cafes.
Education	Computers, printers, UPS, stabilizers, generators, etc. for computer training schools	Hardware for accessing internet, computers to streamline administration, buses and trucks	Increasing competition among private schools is resulting in bigger orders for computers and buses both in Uganda and Tanzania
Transport	Motorbikes, bicycles	Taxis, buses, trucks, tourist vans	Leasing companies have a large portfolio in this sector as it tends to cut across all the sectors.
Small Scale Manufacturing	Hand tools, sewing Machines	Electrical equipment and tools, carpentry tools and equipment, welding machines, grinders, generators, cutters	Market constrained by competition from lower priced, good quality imports, availability of used items and frequent poor workmanship of local products.
Construction	Hand tools, painting equipment, brick making equipment.	Trucks, compactors, brick laying equipment,	Constrained by lack of a vibrant mortgage finance industry.
Entertainment and Hospitality	Chairs, cooking pans, utensils, warmers, tents, cooking stoves, music	Chairs, cooking pans, utensils, warmers, tents,	A growth area because increasing monetary

Sector	Micro-Business (less than$2,500)	Small Business ($2,500 – $50,000)	Comments on Potential Asset Financing
	systems, generators for events organisers	cooking stoves, music systems, generators	economy and the declining social reciprocity. Most profitable services target funerals, weddings and other festivities.
Health Clinics	Examination couch, weighing scale, blood pressure machine, stethoscope, sterilizers, simple microscopes, refrigerators for vaccination, filing cabinets – this is where most demand	Admission beds, larger diagnostic equipment, larger refrigerators, filing cabinets	Growth area considering the relative ill health of the two nations and the levels of unemployment among freshly graduated doctor and paramedics.
Agriculture	Small scale spraying equipment, hand-tools, wheel barrows, bicycles	Tractors, trucks, power generators, land,	Agricultural finance not popular with finance companies because of perceived production, yield price, marketing risks, limited collateral
Small Mining	Pick, shovels, wheel barrows,	Portable compressors, crushers, generators, security alarms, swim suits, pick up trucks, excavators, jigs, processing equipment, gem cutting machine, test kit	High demand in Tanzania with variations in underwater, alluvial, under the rock or aggregate mining. Currently, most small miners enter into “operating” leases

Leasing appears more compatible with small and medium size enterprises seeking larger assets than for micro-enterprises. This suggests that careful analysis of micro-enterprise leasing markets is required.

3.0 Current Sources of Asset Financing for Micro- and Small Enterprises

In East Africa, micro- and small entrepreneurs wishing to finance asset acquisition find themselves with few options in the formal financial markets. The financing mechanisms available are not tailored to meet the asset financing requirements of many micro and small entrepreneurs, and therefore are sub-optimal means of financing asset acquisition.

The East African experience is similar to that in other countries. As Mark Havers[3] argues, “It seems to be generally agreed that there is a financing gap between the micro-loans commonly provided to subsistence enterprises by aid-funded MFIs and the commercial bank loans which are available to well established and capitalised small scale enterprises operating in the formal sector.” Based on the field research, the financing gap in Uganda and Tanzania ranges from businesses valued $1,500 to $100,000. With the exception of Selfina in Tanzania, there are hardly any institutions in Uganda and Tanzania established to address the asset financing needs of micro-enterprises. Small enterprise access to finance from formal lending institutions is limited. The few leasing companies in the market tend to finance assets of greater value than those needed by smaller enterprises.

[3] Mark Havers is a partner at The Springfield Center for Business in Development, UK.

3.1 Formal Financing Options Available

3.1.1 Banks

Formal financial institutions are usually a source of loan financing for those at the medium enterprise level. With the exception of banks like CERUDEB in Uganda, which extends business loans as low as Ush.100,000 (US$70) and Akiba Commercial Bank in Tanzania, which extends business loans ranging from Tsh.500,000 (US$700), most banks are reluctant to serve micro and small entrepreneurs because they rarely meet the often-stringent eligibility criteria and even when they do small loans are costly to monitor with traditional systems. Similar observations have been made in other African countries where banks view small borrowers as riskier than medium and large ones for reasons often related to how difficult it is to obtain accurate client credit information due to geographical remoteness, illiteracy, and undocumented and unreliable incomes. By enforcing stringent collateral requirements for loans and high minimum deposit requirements, banks effectively screen out the vast majority of small clients. (Aryeteey, *et al*. 1991, Aryeteey, *et al.*, 1997, Havers, 2000).

Box 1. "Why We Do Not Lend To MSEs"

- Often do not repay
- Operate in high risk sectors
- Many are overly optimistic
- Lack managerial skills
- Divert loans
- Make low profits
- Face to many managerial constraints
- Many have no borrowing experience
- Many have no borrowing experience

Source: Conditions For Access to Financial Services for Micro- and Small-Scale Entrepreneurs - Deloitte & Touche, 1998.

3.1.2 Hire Purchase

Hire purchase companies like Supreme Furnishers and Tunakopesha Ltd., both of which have operations in Tanzania and Uganda, have been a source of asset financing for low-value items like refrigerators, domestic furniture and sewing machines. However, their eligibility criteria, makes these services unobtainable for most entrepreneurs. Supreme Furnishers in Tanzania require an introductory letter from one's employer or a business license, a photocopy of the applicant's ID, and proof of income (either a salary slip or a bank statement), 4 relatives and 3 friends as guarantors, a down payment of at least 10% of the value of the asset, and regular (monthly) lease instalment payments that do not exceed 30% of the applicant's income. It is clear that their preferred customers are those with regular salaried employment and not those in self-employment. The manager of Supreme Furnishers in Tanzania explained that their problem clients are mainly micro and small business operators who experience seasonal cash flow problems or are simply unwilling to pay off their leases and cannot be easily traced in the event of default.

3.1.3 MFI Financing

MFIs provide short term financing that is designed primarily to meet the working capital needs of micro enterprises. While MFI clients tap into this financing to purchase assets, the MFI lending methodology is often not appropriate for financing larger cost assets[4] (Wright, 2000). In most instances, MFIs in East Africa provide progressively larger loans to their clients who are organised into solidarity groups. Loan cycles usually have a cap on the maximum loan, whilst the client's ability to access a loan is usually contingent on the overall performance of the solidarity group. Although this is not the most efficient financing mechanism, many MFI clients will use it to finance assets because it is the only available option. The disadvantage is that clients have to go through several loan cycles before they can access larger loans. Box 2 illustrates how cumbersome asset financing through MFIs can be.

[4] Usually anything beyond US$1,000.

Box 2. Asset Acquisition through MFI Financing
Mama Sera, a client of YOSEFO, a Tanzanian MFI, runs a hair salon. "Prior to joining YOSEFO, I was already running my salon. I joined YOSEFO because I had heard that they were assisting small business people like myself with working capital financing. I wanted my business to grow, and I needed to purchase an additional hair dryer and steamer. I could not purchase these items right away, so I began borrowing from YOSEFO to try to raise money to purchase the items. With my first two loans of Tsh.50,000 ($61) and Tsh.100,000 ($122) respectively, I bought hair care products. I repaid each of these loans within a four-month period. I then borrowed a third loan of Tsh.200,000 ($245), which I split in two: I put one half in the bank and used the remainder to purchase more stock [hair care products]. It took me another four months to pay off this loan. Once I had repaid this loan, I got a fourth loan of Tsh.300,000 ($368). To this loan, I added the Tsh.100,000($122) I had in the bank and used the Tsh.400,000 ($491) to purchase the dryer and steamer I needed for my salon. While I am grateful for the loan facility I have with YOSEFO, it took me one year to purchase the assets I needed for my salon."

3.2 Informal Financing Sources

Informal financing arrangements are the most commonly used asset financing mechanism for MSEs in both Tanzania and Uganda. Some of the most commonly used informal financing arrangements are detailed below. MSEs will often use a combination of informal asset-financing mechanisms, interspersed with formal financing.

3.2.1 Relatives and Friends

MSE operators in Tanzania and Uganda rely on social networks to meet working capital and asset financing needs. This is by far the most popular financing mechanism and has always been the biggest source of capital. However, financial sector trend analysis with owners indicated that the input by social networks is waning due to increased financial pressures. Ongoing economic restructuring in the public sector has resulted in a significant portion of the workforce being retrenched and therefore being unable to extend assistance to their kin. Also, the social network has been abused, resulting in some relatives' reluctance to extend financial assistance. Trust and honesty are increasingly becoming scarce. (Rutherford, 1999, Mutesasira, *et al*, 1999)

3.2.2 Personal Savings and Re-investment of profits

Many MSEs are owned and managed by individuals who rely on personal savings and reinvestment of profits to finance assets and working capital (see Box 3).

Box 3: Saving to Acquire Assets
Mama Vedi, a fishmonger at Dar-es-Salaam's Kariakoo market, sells fresh water fish. "In my business it's important to have good storage facilities otherwise your business is sunk before it gets off the ground! When I first started out, I did not have enough money to buy a freezer. I met a *tajiri* who rented me his fridge. I would pay a monthly rental charge for the use of the freezer. During this time, I put aside some savings from my business profits to purchase my own freezer. After saving steadily, I was eventually able to buy my own freezer.

As my business continued to grow, I sought out additional financing from an MFI. I used some of the loan money I got to buy additional freezers. I now rent out some of my own freezers for Tsh.20,000 [$25] a month to other fishmongers who are not yet able to purchase their own freezers."

3.2.3 Liquidating Assets

Entrepreneurs often find it difficult to accumulate lump sums from their business cash flows. Some entrepreneurs will opt to sell off a less productive asset, and use the money (plus additional cash if necessary) to purchase a more necessary asset. .

3.2.4 Reciprocal Asset Usage Arrangements

Reciprocal arrangements arise in cases when the entrepreneur cannot fully utilise an asset because their operation is too small, or when the entrepreneur cannot raise the capital to acquire the required asset. These arrangements are fairly common among carpenters in both Tanzania and Uganda. A number of carpenters, none of whom own the full range of tools required to run a full-scale workshop, cluster together. Each carpenter has his own clientele with different orders. However, the carpenters come to an agreement on how to share the tools among themselves. Sometimes a small fee is charged for the equipment per usage, though the most common arrangement is free use of tools on a basis of goodwill and mutual support.

3.2.5 Informal Operating Leases

Some entrepreneurs have entered into rental arrangements with owners of assets employing "informal operating leases". Rental fees are paid on a daily, weekly or monthly basis. Most informal operating leases do not have a fixed term and may be cancelled at any time by either party. There are no formal agreements to be signed. Arrangements are reached on a verbal basis. The assets may or may not be rented for their useful life. Verbal agreements determine who is responsible for maintaining the asset, in most cases the lessee is responsible for the general maintenance of the asset, but in instances where there is need for major repairs, cost-sharing arrangements between the lessor and lessee are sought (see Box 4).

At a micro level, these informal operating lease arrangements are very common across East Africa with taxi operators, *boda boda*[5] drivers, fishmongers, tailors, small miners, construction workers, fishermen, etc. In the agricultural sector in Uganda, coffee processing factories are leased for a season (a 3-4 month period), and the fees are negotiated based on the factory's capacity and the assumption that the factory is utilized for 8 hours a day.

Box 4. Informal Operating Lease (*Kukodisha*)

In Tanzania, taxi operators who cannot afford to purchase a vehicle of their own enter usage arrangements with vehicle owners (*tajiri)*. Luza is one such operator.

"I have been renting my taxi from my *tajiri* for the past 3 years. I operate the taxi six days a week, with Sunday as my day off. Out of my daily collections, I pay my *tajiri* Tsh.10, 000 ($12). I get to keep any collections over and above this daily remittance to my *tajiri*. Out of the money I keep as income, I fuel the car and take care of any routine vehicle maintenance. My *tajiri* and I have an arrangement such that if there is a big repair job, we split the cost.

Business is usually good during the first half of the month, when people have been paid and they have ready cash. During the latter half of the month, business is not so good, and there are times when I can't make up even the Tsh10,000 I have to remit to my *tajiri*. We have an understanding where I can supplement the shortfalls with the excess income I collect on good days."

Over the past three years, Luza has remitted Tsh. 9.36 million ($11,485) to his *tajiri*, which could easily purchase a good reconditioned car. He draws an average daily income of about Tsh.7, 000.

3.2.6 Rotating Savings and Credit Associations (RoSCAs) and Accumulating Savings and Credit Associations (ASCAs)

Members of RoSCAs and ASCAs make regular fixed contributions to a pool over a specific period. Each member of the group receives the total of one collection to use at their discretion. Some RoSCAs are "asset RoSCAs" whereby the group purchases a tool or piece of equipment on behalf of the individual, provided its value does not exceed the periodic amount collected. Many micro- and small entrepreneurs belong to

[5] These are bicycles and motorbikes used as taxis, especially in Uganda.

RoSCAs, which they use to help them fill their financing gaps for asset acquisition or working capital or a combination of the two. (Adams and Fitchett 1992; Rutherford, 1998; Mutesasira, 1999).

3.2.7 Moneylenders
Often there are wealthy business people in the community who are willing to lend money to individuals, generally on a short-term basis. Moneylenders usually require some form of collateral to reduce their lending risk. The most common type of security for them is a car logbook (the basic owners' documentation for vehicles in East Africa) or in Uganda post-dated cheques, where it is a criminal offence to bounce a cheque. Repayment terms are negotiated between the moneylender and the borrower, with interest rates ranging from 10% to 30% per month. With few financing options, many entrepreneurs will enter transactions with moneylenders to finance assets (Rutherford, 1999; Mutesasira *et al*, 1999).

3.2.8 Lay-away Arrangements
In lay-away arrangements, customers make a deposit against an asset, which remains with the vendor until payment is completed. Lay away arrangements continue to be a business asset financing mechanism, but are now predominantly used to purchase household assets, as they tie up much needed business capital.

4.0 Overview of Leasing
Financing arrangements mentioned in the previous section, helpful as they may be, frequently fail to meet the needs of small entrepreneurs, leaving financing gaps especially for small enterprises. One of the most popular asset financing products in most of the industrialized world is leasing. The research team examined the potential for leasing as an alternative financing arrangement in the East African market that could potentially fill this financing gap. Leasing was examined in the context of the entire financial landscape. The rest of this paper is devoted to this topic.

4.1 What is Leasing?
A lease is a transaction in which an owner of equipment (the lessor) allows another party (the lessee) to use equipment, and for that usage, the lessor charges rent.[6] Once the two parties enter a contractual agreement over access to and use of the equipment, the lessee is obligated to make periodic payments to the lessor for the duration of the lease. A lease represents medium term financing for asset usage, usually running for three to seven years. Most lease contracts are characterised by the following terms:

1. The lessor remains the owner of the equipment for the duration of the lease, while the lessee acquires temporary possession and usage of the equipment.
2. The lessee may be required to make a deposit payment on signing of the lease, and to make periodic payments to the lessor for the duration of the lease term.
3. The lessor may or may not recognise a salvage value in calculating the leasing payments.
4. In many instances, the lease cannot be cancelled. Should the lessee cancel the lease, they may be charged a substantial penalty for the cancellation.
5. The lessee is responsible for property taxes, insurance, and repairs and maintenance that are not covered by warranty.
6. When the lease period ends, the lessee has the option of purchasing the equipment, renewing the lease or returning the equipment to the lessor.[7]

4.2 Types of Leases
4.2.1 Finance Lease
A finance lease, also known as a capital lease, allows the lessee to pay for the usage of the equipment with the option of owning the equipment on expiration of the lease term. The lessor pays for equipment that the lessee has chosen, and the lessee uses that equipment for a significant portion of its useful life. Financial

[6] "What is a Lease?" Euromoney Publications, 1995, p.4.
[7] Bass, Jacqueline, and Katrena Henderson, "Bamako 2000: Innovations in Microfinance", Weidermann Associates, Inc., and Development Alternatives Inc., p.2.

leases are also known as full payout leases, because payments during the lease term amortize the lessor's total purchase costs with a residual value of up to 5% of the original acquisition price[8]. In Uganda, a lease is defined as a finance lease if over 80% of the cost of the assets is recovered within the term of the lease.

Finance leases are known in Uganda as *liizi* and in Tanzania as *mkopo*[9]. Many micro and even small entrepreneurs are unable to clearly distinguish a financial lease from a medium term asset-financing loan since the accompanying conditions of both arrangements are very similar.

4.2.2 Hire Purchase Lease

Hire purchase leasing is used to finance smaller ticket items, such as motorcycles, sewing machines, refrigerators etc. The lessee makes a high initial down payment, possibly up to 30% of the purchase price, and with each lease payment retains a higher percentage of equipment ownership. At the end of the lease term, the lessee assumes full ownership without making a residual payment. Examples of hire purchase companies in Tanzania and Uganda are Supreme Furnishers, Tunakopesha and Musicraft. The first two companies have a presence both in Uganda and Tanzania, the latter only in Uganda.

While hire purchase is similar to the finance lease in many respects, there are two features that distinguish them:

1. With hire purchase, the lessee assumes increasing ownership of the asset with each payment made. On the other hand, in the financial lease, the lessor retains full ownership of the asset until it is fully paid for.
2. The down payment is considered an instalment payment towards asset purchase in hire purchase. However, in the finance lease, this down payment is regarded as additional security and not a payment towards asset ownership.

4.2.3 Operational Lease

An operational lease involves the lessee renting an asset over a period of time that is substantially shorter than the asset's economic life. The lessor retains ownership and claims depreciation on taxes. Operating leases generally run for three years or less, and the lessor assumes a share of the risks and rewards inherent in the transaction and anticipates the asset's resale value at the end of the lease term.[10] Apart from DFCU leasing, which has discovered a niche among multinational companies, most leasing companies are not keen on operating leases.

Micro- and small entrepreneurs in Uganda and Tanzania want to own the assets they use. Assets are seen as a form of savings. Ownership gives entrepreneurs greater control over their business and the ability to obtain additional capital by collateralising assets once the lease term is up. In the case of the construction industry, contractors need to own their equipment if they are to be successful in tenders - construction companies are often required to display their equipment to their potential clients as verification that they have the capacity to do the job. Entrepreneurs' preference for ownership means that finance leases are preferred over operating leases, most East African entrepreneurs enter operating lease arrangements only because they have limited capital and cannot raise the required lump sum. Correspondingly, few financial institutions and lessors provide operating leases for micro-, small and medium enterprises. The key reasons behind this reluctance include the operational complexity of managing operational leases, lack of the initial investment capital, and the tendency for lessees not to maintain the leased equipment.

[8] *ibid*., p.3.
[9] It should be noted that "mkopo" in Swahili is also the term used to refer to a loan.
[10] ibid

4.3 Financial Classification of Leasing[11]

For accounting purposes, the classification of a lease is important both to the lessor and the lessee, because it determines how the lease is accounted for in the financial statements. Financial and operating leases are classified differently from both the lessor and lessee perspective.

Under a financial lease, the lessor accounts for the lease as a bank would account for a loan. On the balance sheet, the lessor records a net investment in lease receivable. In the income statement, the interest income earned on the outstanding lease receivable. For the lessee's purposes, the equipment is recorded as an asset. A corresponding liability is recorded on the balance sheet. In Uganda, the lessee's income statement captures the depreciation on the asset and the interest on the lease as expenses (i.e. the lease payments are split into principal and interest payments).

For accounting purposes of an operating lease, the lessor is treated as the owner of the asset. The equipment cost is recorded as an asset on the lessor's balance sheet, and depreciated over the lease term. Rental payments received from the lessee are recorded as income on the income statement. For the lessee's purposes, the rental payments are captured on the income statement as an expense. No record is made on the lessee's balance sheet since the lessee is not the owner of the asset.

4.4 Tax Classification of Leasing

Tax laws and procedures governing leasing vary between Uganda and Tanzania. In Uganda, the leesee is recognized as the owner of the equipment from a tax perspective and so is entitled to receive the tax benefits associated with ownership of the equipment (i.e. depreciation and any tax credit due according to the tax authorities). In Tanzania, the lessor is treated as the asset owner for tax purposes and therefore enjoys the tax benefits of depreciation.

Many small entrepreneurs in Uganda lack the skills and discipline for maintaining standard accounting records, and those that do frequently operate at such a small margin that they are unable to take advantage of depreciation deduction. For these reasons many people familiar with leasing argue that depreciation benefit should be given to the lessor to allow the lessor to pass on the benefits to the lessee in form of lower interest rate and fees.

Potential for Leasing – Examining the Leasing Concept in the east African Context

5.1 The Leasing Product

5.1.1 Lease Amount

Most formal leasing companies like DFCU, ULC and EADB[12] offer large leases much to the satisfaction of potential entrepreneurs. However, most lease companies apply stringent eligibility criteria, which effectively close out small-scale enterprises from obtaining leases.

The lease sizes of the different companies included in this study varied with the market targeted by the leasing institution. Among the companies interviewed, ULC has the highest average lease amount of $50,000. ULC's leases as well those of DFCU and EADB, target medium sized enterprises. Selfina's average lease amount of $650 is more appropriate for most micro-entrepreneurs seeking to finance small assets like freezers and refrigerators. Selfina's leases are within the same range as MFI working capital loans, which are frequently redirected to finance asset acquisition. This suggests that micro-entrepreneurs with asset financing needs can be serviced well by MFIs as asset financing addresses their clients' needs and fits well with MFI mandates. On the other hand, medium sized businesses can be better reached by leasing companies.

The limiting factor for most small entrepreneurs in need of asset financing at an appropriate level (averaging $25K) is the access requirements (combination of collateral and income) for which even the largest MFI loan

[11] Material for this section is drawn from "What is Leasing?", Euromoney Publications, 1995

[12] As indicated earlier, EADB has only a few years of experience and therefore has not done much leasing.

(average $1,500) does not qualify them. It can be argued that while all three market segments are still under-served and to a large extent even not served, small enterprises represent the least served market with the highest growth potential for leasing products. Akiba and CERUDEB banks, which are attempting to serve the small enterprise sector, agree that they have barely tapped into the potential market.

Additional evidence suggests that contrary to the high level of demand for formal financial services among small enterprises, the supply of financial services is shrinking. Whilst MFIs, like PRIDE Tanzania indicate a relatively high maximum loan amount, only a few clients have been able to access even a quarter of it. Furthermore, the staff interviewed at PRIDE are seriously considering lowering the maximum loan amounts because of increasing repayment problems with loans above $1,500. Only 148 of PRIDE's clients out of several thousand in the Dar-Es-Salaam area have a loan in excess of $1,500 even though the maximum loan amount is about $7,000.

Table 2. Range of Lease Amount

Tanzania	***Selfina****	***Akiba*ǂ**	***United Leasing Co.****	***Supreme Furnishers*ǂ[13]**	***SIDO*ǂ[14]**	***PRIDE*ǂ**
	$650 to $7,500 average - $650	$10,000 to $18,500	Average lease is $50,000	$400 to $2,500	$7,500 to $12,500	$650 to $6,000
Uganda	***DFCU Leasing****	***CERUDEB*ǂ**	***EADB*[15]***	***UWFT*ǂ**	***Uganda Gatsby Trust****	***UMU*ǂ**
	$10,000 to $150,000 $25,000 is the average	$60 to no upper limit, average loan size is $650	$20,000 to $80,000 $50,000 is average	$150 to $1650	Up to $5500	$160 to$2200

Note: Exchange rates used: Tsh.815 to the dollar and Ush.1,850 to the dollar. Amounts in the table are rounded off.

*= Indicated leasing companies.

ǂ= conventional lender.

5.1.2 Lease Term

Recent bank closures in Tanzania and Uganda have created very cautious banks that typically extend only short-term loans no longer than one year. This makes leasing attractive as it extends the finance term to between 2 to 5 years. For example DFCU, ULC and EADB terms range from 24 to 60 months compared to CERUDEB and most MFIs' terms that range between 4 months and 12 months[16]. However, some banks are moving towards offering asset-financing options of up to two years. Akiba Bank for instance has introduced a taxi loan product through which clients lease cars for a 2 to 3 year period. A different approach is adopted by ANED in Bolivia where the policy is that terms should not exceed 2/3 of the useful life of the leased asset. ANED has observed that based on the demands of peasant farmers for machinery and equipment, these periods may vary between 2 and 7 years (Mauricio, 2000).

Some MFIs like PRIDE-Tanzania have provisions for a 2-year loan. However, these MFIs are reluctant to extend these larger loans to clients as they are difficult to administer using the solidarity group lending methodology. Group members become increasingly reluctant to guarantee colleagues who are borrowing large loans, because their risk exposure becomes much greater. Larger loans have resulted in repayment

[13] This is a hire purchase company operating both in Uganda and Tanzania.
[14] SIDO is a Government of Tanzania program that used to provide capital asset loans for medium term.
[15] This is a new programme targeting small and medium enterprises.
[16] CERUDEB has recently introduced a two year commercial loan.

problems, as it is increasingly difficult for clients to come up with the repayment instalments, particularly under the framework of MFIs that require weekly repayments. Many MFIs argue that longer-term loans are riskier and since they have limited funds at their disposal, they prefer to concentrate on shorter-term less risky loans.

Leasing compared to bank finance offers medium term finance that allows for appropriate instalment payments over a longer period of time. However, experience shows that not all micro-entrepreneurs actually require medium term asset financing. Many Selfina lessees, purchasing small assets, have been able to complete payments 10-12 months in advance. This suggests that it is only as the asset financing needs grow larger (say $1,500) that medium term financing becomes a necessity.

For a leasing company to operate comfortably and viably, it must have adequate access to sources of long-term financing at low interest rates as longer-term loans tie up funds for a considerable length of time. This is important for those considering entering the leasing industry.

5.1.3 Flexibility, Mode and Frequency of Payment

Most MFIs currently require weekly repayments while banks and leasing companies tend to have monthly or quarterly repayments to minimize the administrative costs. In order to minimize collection cost and risk ULC and DFCU, like NLC in Pakistan, require clients to complete and sign post-dated cheques for each monthly payment for the term of the lease. For example, a 3-year lease requires signing a total of 36 post-dated checks. The leasing company then banks these as they fall due (Havers, 2000).

Many entrepreneurs are comfortable with the frequency of payments offered by leasing and other longer-term asset-financing options. However, entrepreneurs with businesses that experience wider seasonal variations in income prefer repayment schedules that are matched to their cash flows.

Lessees that have the freedom to select a repayment term that allows them to make the regular instalments comfortably are more likely to result in a better performing portfolio. This is especially important for entrepreneurs wishing to purchase large and costly assets who find financing such assets over the short-term very stressful.

The lessor needs to understand the cash flow patterns of their key markets if they are to design the most appropriate payment terms for their clients. Some companies already do this. For example, ULC in Tanzania has a flexibility option for its clients operating tour vehicles. Their payment instalments are larger during the peak tourist season, and smaller during the low season. The smaller low season payments are referred to as "contact payments" designed to maintain the client's payment discipline and keep the client in touch with the lending institution (see Box 5).

Lessors can also explore *stepped flexibility*, where larger payments are made during the earlier part of the lease, usually the first year, when equipment maintenance costs are minimal and then progressively smaller instalment payments are made in the subsequent years.

Other flexible arrangement are made by EADB, CERUDEB Bank and DFCU where schools have leased buses and payments are expected at the beginning of the term when students have just made school fees payment. CERUDEB also allows seasonal payments for agriculture sector loans where repayments are expected after the sale of produce - no contact payments are expected in either case.

Most clients interviewed preferred monthly payments. However, ULC feels that weekly repayments may help to instil discipline and ease the logistics for monitoring more closely the performance of problem clients. This approach has tremendously improved the performance of some ULC clients. This scheme is similar to the typical MFI frequency of payment. Institutions wishing to finance assets for less wealthy clients may want to consider this with new clients in an effort to break down repayments into small, manageable instalment amounts, instil discipline and to gauge client commitment.

Box 5. Flexibility - Matching Payments to Cash Flows
United Leasing Company in Tanzania has lease financed a number of vehicles in the tourism industry. Martin Taylor, General Manager of ULC, shared with us their experiences. "Tourism in Tanzania has a very strong seasonal pattern," he explained. "Tour operators hardly make an income during the February-July low season. Over time, ULC has designed a repayment schedule that fits the cash flow variations of the industry. ULC has in this way been able to minimize risks to the institution and serve growing untapped markets."

"In the transportation sector," Martin adds, "we have ratio payments. The lessee makes larger payments at the beginning of the lease when the trucks/buses require minimal maintenance. Up to 75% of the value of the lease is recovered during the first year when these vehicles are in top shape. By the third year, the instalments are quite small in size and the lessees are able to give more money to maintenance should the need arise."

5.1.4 Grace Period

Formal financing institutions, including MFIs, banks and leasing companies, generally do not give their clients a grace period. The exceptions are CERUDEB, which gives grace periods of up to 7 months on agricultural loans, and SIDO, which offers grace periods of up to 6 months on some equipment financing. Most leasing companies argue that the one-month between disbursement and the first payment is adequate for the operator to install the equipment and put it to economic use where it will begin generating an income immediately. While this may be true in many instances, leasing companies need to be aware that certain assets have a lag time between installation and full productivity. Many lessees would therefore find an initial grace period desirable. This is especially true for larger assets, assets with slower cash conversion cycles and equipment that needs to be installed and tested for a period of time before it becomes commercially active (see Box 6). It is important for lessors to design flexible lease terms that allow specific exceptions for certain sectors and business types. Whilst trade and service businesses may be given a single month because of their more regular cash flows, manufacturers purchasing plants may require longer grace periods, as might lessees ordering equipment from abroad.

Box 6: Is a Grace Period Really Necessary?
One lessee in Uganda shared his experience with us. He imported equipment from abroad and there were delays in the arrival of the equipment. By the time the first payment fell due, the equipment had not yet arrived. Because he had deposited post-dated cheques with the lessor, the operator was forced to raise the payment for the asset or risk defaulting on his cheques and face legal action.

When the equipment eventually arrived, there were further delays in clearing customs. By the time that it was cleared, installed and fully operational the lessee had already made several months' payment despite not having used the equipment productively.

5.1.5 Interest Rates, Transaction Fees, Transaction Cost and Tax Benefits

Unlike many countries around the world where leasing institutions are able to offer financing at comparatively lower interest rates than those offered by commercial banks and other formal financing institutions, the effective leasing interest rates in Uganda and Tanzania are significantly higher than those of conventional bank interest rates. The nominal interest rates of leasing companies are between 23-30% (declining balance) and are comparable to those of the banking sector, which are between 22-28%, but are lower than MFI interest rates, which are typically at 30% (flat) or above. From an interest rate viewpoint therefore, leasing is no more attractive than bank financing (see Table 3). This makes leasing a relatively expensive source of finance in Tanzania and Uganda. Although during the course of our interviews, lessees were aware of the effect of the relatively large deposit on their working capital needs and they rarely considered leases in terms of the effective interest rate.

However, analysis should not stop at effective interest rates but should consider transactions costs to lessees. Lessees benefit from lower transactions costs resulting from quick and simple procedures compared to time consuming group meetings required by most MFIs, transportation costs, and corruption costs characteristic of borrowing from a typical commercial bank.

Whilst leasing interest rates are higher than those available from commercial banks they tend to be rather lower than those which are available from moneylenders in the informal system. In East Africa as well as Pakistan, it is availability rather than price that is of most importance to MSEs. Price only becomes an issue if one is fortunate enough to have a lot of available finance opportunities (Havers, 2001).

Table 3. Interest Rates and Fees for Selected East African Financial Institutions

	Gatsby Trust (ls)	***DFCU (ls)***	***CERUDEB (ln)***	***EADB (ls)***	***UMU (mc)***	***UWFT *(mc)***	***Selfina * (ml)***	***Akiba (ln)***	***ULC (ls)***	***MEDA* (mc)***	***PRIDE * (mc)***
Deposit	20%	15-20%		15-20%	20%	15%	15-30%		30%	20%	25%
Interest Rate	32%	20-24%	22%	24%	48%	30% flat	23-30%flat	24-30% flat	28%	36%	25%
Appraisal fee	2%	2%	2%	2%	3%				2%		
Monitoring/ Other fees	2%		2%					1.5%			
Legal + Commitment								2%			
Insurance		6%				1%					
Application fees[17]			5,000			5,000	2,000	10,000			
Commission			2%	2%		2%					
Frequency of payment	Monthly, 2 weeks	Monthly, quarterly	Monthly	Monthly, quarterly	Month	Weekly	Weekly	Weekly, monthly	Monthly, weekly	Monthly	Weekly
APR	62%	64%	34%	50%	82%	116%	103%	62%	66%	55%	80%
Effective Interest Rate to Client)	68%	70%	34%	55%	89%	124%	111%	62%	72%	60%	86%

Note 1: The interest rate of Institutions marked with an asterisk is flat rate basis while the rest are declining balance basis.
Ls=lease; cb=commercial bank; mc=microcredit; ml=microlease; ln=loan
Note 2: Assumptions for calculation of effective interest rates a) where a range of periods, rates and deposits is given the shortest frequency of payment, highest deposit and highest interest rate is used to give a maximum effective interest rate. b) Fees and commissions are a percentage of initial loan amount. c) Client deposits are repaid to the client one month after the end of the contractual period. d) The contractual period is taken to be 12 months e) Application fees have not been taken into account – these would increase effective rates particularly for small loans.
Note 3: The interest rate is expressed in terms of both an Annual Percentage Rate and in terms of the total cost to the client over the 13-month period until the client receives his/her refund.

5.1.6 Insurance

As part of risk management, leasing companies require lessees to take out comprehensive insurance ranging from 3-8% of the assets value. However, the typical micro-level clients find the insurance concept illusive and tend to see the periodic premium as a burdensome cost for which they derive no benefit. Many of these clients feel that should any problems arise, they are willing to take up the cost of repairing the asset. Selfina Ltd. does not find it necessary to take insurance because, according to the finance manager, they finance

[17] Figures are given in the currency of the respective countries.

lower cost assets. However, lessees who finance costly assets, (averaging $5000 and above) tend to appreciate the value of insurance.

On the other hand, NLC of Pakistan ($10,000 average lease) imposes **insurance on the life of the client**, so that NLC does not have to repossess the asset when the client dies. Mark Havers (2000) argues that this is both prudent for NLC and very humane for the client's family. Equally, NLC takes out insurance to cover all risks (fire, theft, etc.) on each leased asset as well as residual value insurance in case a repossessed asset is worth less than the outstanding amount of the lease. All the costs of this insurance are included in the lease payments made by the client. This reduces the resistance by clients to have insurance while securing the needs of the leasing institution.

5.1.7 Deposits and Collateral

Due to limited information on the credit history of entrepreneurs in the micro- and small enterprise sectors in East Africa, leasing institutions minimise their risk by requiring lessees to put up deposits and pledge other assets in addition to the leased equipment. Before a lessee can lease an asset, most leasing companies will require a deposit. Dr. Victoria Kisombi, Executive Chairperson of Selfina Ltd., explained that, "It (the deposit) is a litmus test of potential to repay. Clients should give up something they are afraid of losing." Leasing practices in developed financial markets place the deposit at 1-4% of the cost of the asset, with the leased asset forming the bulk of security for the lease, in many instances no additional collateral will be required. However, in East African markets, lessors require deposits of between 15-30% of the cost of the asset. In addition to this, lessees have to pledge additional collateral such as real estate, land titles and other business assets.

Table 4. Deposit/Down Payment Requirements of Selected East African Financial Institutions

Tanzania	***Selfina****	***Akiba***	***ULC****	***Supreme Furnishers*** ***	***SIDO***	***PRIDE***
Deposit/ Down payment	15-30% deposit	25-40% down payment	30% deposit	10% down payment	20% down payment	25% savings deposit
Uganda	***UNIDO/Gatsby Trust****	***DFCU ****	***CERUDEB***	***EADB****	***UMU***	***UWFT***
Deposit/ Down payment	20% deposit	15-20% deposit	25% equity	15-20% deposit	20% savings deposit	15% savings deposit

* = Indicated leasing companies. The rest are conventional lender with the exception of Supreme Furnishers which is a hire purchase company

High deposit and collateral requirements seen in Table 4 have unfavourable implications for lessees. The lien on the assets pledged limits access to working capital loans from other financial institutions. Recognising the need for working capital, Selfina introduced a **lease back** arrangement that allows repeat clients to formally transfer ownership of an asset to Selfina in exchange for a working capital loan.

Box 7. Reasons for High Deposit Requirements

Leasing companies in Tanzania and Uganda require high deposits from lessees because:

- Availability of a deposit helps the lessor assess the lessee's ability to pay off the lease.
- The deposit gives the lessee a stake in the deal and builds commitment to repayment.
- If the asset is repossessed, the lessor uses the deposit to refurbish the asset before selling it.
- The deposit provides additional collateral.

Most potential and existing clients interviewed felt that raising the lump sum deposit in order to qualify for a lease was one of their biggest challenges in qualifying for a lease. One suggestion is that leasing companies can work in partnership with banks or MFIs, requiring potential leasing clients to open contractual savings accounts into which they deposit money and build up the required deposit for the lease. Akiba Bank in Tanzania advises potential lessees to save with them in advance and build up a sufficient deposit to access credit. This arrangement can assist the leasing company to establish relationships and to assess the financial discipline and the cash flow patterns of the potential client. It would also enable the potential clients to raise the deposit over a period of time. A company like DFCU Leasing is in an ideal position to take advantage of such an arrangement because it has a sister banking institution, DFCU Bank, with which potential clients can open their contractual savings accounts.

5.1.8 Ownership

The asset remains the property of the lessor for the duration of the lease, but is in the possession of the lessee. Ownership is transferred to the lessee only after the asset has been paid for fully. However, ownership is easier to establish for assets with clear ownership titles e.g. cars and motorcycles, which have logbooks. For other assets with no deed of title, it can be difficult in practice to establish ownership because the lessee has possession of the asset with nothing to demonstrate that the asset belongs to the lessor. This is one reason why leasing companies find it more convenient to lease vehicles, which account for 60-70% of the portfolios of the Tanzanian and Ugandan leasing companies.

Of course ownership of assets has liability implications. EADB points out that if a leased vehicle is involved in an accident, the liable party is the lessor as the owner of the vehicle who then has to intervene with all the attendant court issues. This is another reason why lessors insist on comprehensive insurance on assets.

In many countries around the world where leasing has become a popular form of asset financing, the lessor claims ownership of the asset for both legal and tax purposes. In these cases, the legal ownership of the asset enables the asset to serve as security and eliminates the need for additional collateral because the ownership of the asset grants the lessor a tax benefit due to the asset’s depreciation. In Uganda, the lessor claims legal ownership of the asset but cannot claim tax benefits. This means that the lessor cannot pass on the tax benefits to clients through lower instalment repayments. Many small entrepreneurs are unaware of the concept of ‘depreciation deduction’, besides which, they habitually record low profits making it impossible to take full advantage of a depreciation deduction. Clearly it would be worthwhile for stakeholders and interested parties to lobby the government for a change in regulation in order to support the growth of leasing into a popular asset financing option. It would be particularly attractive in the Ugandan context for the lessor to be able to claim depreciation, which hopefully would be passed on to clients.

5.1.9 Guarantors

In the East African markets, leasing companies require guarantors for two reasons. First, guarantors can be called on to pay should the lessee fail to provide an instalment payment. Guarantors also lend credence to the lessee’s creditworthiness. The guarantee requirements of leasing companies in Tanzania and Uganda are similar to those of the banking sector. EADB, ULC and DFCU require at least two guarantors, usually company directors. MFIs have more stringent guarantee requirements, usually requiring about five guarantors. Akiba Commercial Bank in Tanzania, whose business has been founded on solidarity group lending to micro- and small entrepreneurs, has introduced a leasing arrangement for taxi operators in Dar-es-Salaam. The lessee is guaranteed by his/her centre[18], which is comprised of five members. While it is too early to tell how well this will work in the long term, it is important to note that the co-guarantee mechanism is ineffective as the primary security on the lease because as the lease amounts become increasingly larger (in excess of $1,500) the integrity of the guarantee mechanism begins to collapse. In PRIDE Tanzania, even though the cap on lending is Tsh.4 million ($4,908), there is reluctance to extend loans in excess of Tsh.1 million ($1,250) because of the unwillingness of the group members to increased risk exposure by guaranteeing larger loans.

[18] A group of five within the taxi operators association.

Uganda Gatsby Trust, working in collaboration with UNIDO, has clubs of small-scale industrialists and intends, just like Akiba Commercial Bank in Tanzania, to use the local clubs to screen potential clients and co-guarantee the leases. Empretec in Ghana uses a similar method. This is an area that needs further consideration and research in an effort to reach clients using mechanisms other than the typical MFI group lending approach.

A cross section of MFI clients, particularly those interested in leasing, expressed a preference for individual leases with one to two guarantors who are not necessarily fellow lessees. This sentiment was particularly true of MFI clients who were familiar with the group lending methodology where group members with smaller loans become increasingly reluctant to guarantee those taking larger loans.

5.1.10 Preference of New over Used Equipment
In most instances, lessors and lessees prefer to deal in new assets. However, due to economic considerations, second hand equipment is leased. Global practices indicate that most leasing companies insist on only leasing brand new equipment. However, some companies in East Africa find this to be unduly restrictive for MSEs. For example, virtually all light engineering workshops use second-hand machines, so they decided to allow leases on used machinery. Clearly, this approach requires caution since it is open to abuse through inaccurate equipment valuation. Engaging reputable, independent machinery assessors whose valuations can be relied upon to determine resale values accurately and thereby determine lease amounts can reduce this risk. This approach has worked well in Pakistan and is worthy of experimentation in East Africa.

There are varied opinions over this practice from both lessors and lessees. Apart from ULC, which does not finance used or reconditioned assets, all the other leasing and finance companies prefer to deal with new assets but will often finance used or recondition assets. ULC argues that in the past it faced so many complications arising from the sub-standard performance of used equipment and lack of warranties that they introduced a policy of financing only new items. Other leasing companies argue that their clients cannot finance new assets because these assets would be up to twice as costly as purchasing reconditioned equipment. Some second-hand assets, such as cars, seem to perform well and will last for longer than the lease term.

Box 8. "You Buy Cheap, You Pay Expensive!
"We have three choices in our business," explained Joseph, a small-scale carpenter in Ilala, Dar-es-Salaam. "The new imported equipment is very expensive. I cannot make enough money to pay for it even if you gave me a lease. The second option is the 'man-made' (new locally made equipment). I would keep away from these [tools] because they keep breaking down and cannot serve for long. The third option is 'original' (imported refurbished or new equipment). This (equipment) is a bit more expensive but reliable. I would prefer these to the cheap locally made because when you buy cheap, you pay expensive."

Clients' opinions varied from one sector to another and from one lessee to another. Selfina clients preferred new items to used items. They argued that the longer economic life of a new asset, its limited maintenance costs and its efficiency makes it preferable even though the price may be higher. Those in the small manufacturing sector categorised assets according to their point of origin (i.e. imported used equipment and locally made new equipment). Save for equipment like maize mills, the preference among this group of operators was for used imported, refurbished equipment and tools.

5.2 Systems and Processes
5.2.1 Information and Sensitisation
Leasing in the formal sector is not a common asset-financing channel. Further, lease financing is not yet widespread in the East African markets. Thus, many business operators, particularly in the micro-, small and medium enterprise sector, have a poor understanding of how conventional leasing arrangements operate. The

result is a need for information and sensitisation sessions to introduce the potential lessee to the leasing concept, detailing the clients' rights and obligations under a leasing arrangement.

From the lessee's perspective, the information and sensitisation sessions have proved invaluable. In Tanzania, micro-leasing clients ranked the information and sensitisation session as the most important product attribute. They explained that this initial information session detailing their rights and obligations played a major role in influencing their performance once they secured a lease. In response to the repayment problems they were facing, some of Akiba's clients commented, "If we had known all these things (their obligations under the lease) from the start, we would not have gotten into trouble. They should have told us these things at the start."

Leasing companies in Tanzania and Uganda do not advertise their services as the majority of them face financial constraints and the demand for their services exceeds their financing base. Rather than advertise, these companies sift through inquiries in an effort to select people who have viable businesses that would both benefit from the asset financing services and readily meet the financial obligations.

The leasing companies generally rely on information being transmitted by their current clients through word of mouth. Interested parties seek additional information by coming to the institution's offices to make further inquiries. During this initial session, the leasing company solicits preliminary information that allows it to make a decision on whether the party can be considered as a potential client. Selfina Ltd. has weekly sensitisation sessions through which it informs business operators about the services it provides. During these sessions, based on an informed decision, the attendees decide whether they feel that the services offered by Selfina would be useful or not.

This information and sensitisation process allows the institution to establish whether potential clients meet the prerequisites for leasing. This screening helps reduce the potential overheads that an institution would incur if it were to run a full-scale appraisal on every potential client that approaches the institution for financial support.

5.2.2 Eligibility and Selection Criteria

While the eligibility criteria of asset financing institutions are quite stringent in Tanzania and Uganda, simple eligibility criteria have been sited as one of the advantages of leasing to the lessee. Bass and Henderson (2000) argue that the simplicity of the access requirements results from the fact that leasing companies evaluate credit history on shorter terms and leasing relies on the asset itself as collateral. However, the reality in Tanzania and Uganda is different. While leasing companies may require shorter credit histories, their requirements are as stringent as those of commercial banks and certainly more stringent than those of MFIs. The result is that they are out of reach for the typical small enterprise operator who rarely keeps the kind of records required (see Box 9).

Box 9. General Eligibility Criteria in Leasing

- Business license
- Audited accounts
- Bank statements of the last 6 months
- Deposit of 15–30% of the cost of the asset
- Additional collateral (often registered)
- Memorandum and articles of association
- Certificate of incorporation/business license

NB: *Cash flow projections and business plans, while required, are often not weighted heavily.*

Formal leasing companies finance more expensive assets that draw a higher risk to the institution and might justify the stringent access requirements. However, small-scale enterprises are unable to meet many of these access requirements. Formal leasing companies wishing to finance asset acquisition for the micro- and small enterprise sector might opt to work through strategic partnerships such as MFIs, who can refer upper end clients with an established credit history and hence minimize the risk involved in working with this market segment.

For clients that are not part of any MFI and therefore have no credit history, the challenge of gaining access still remains. Leasing institutions will have to introduce access requirements that minimise risks but do not result in costly appraisal processes. Insight may be gained from Akiba Commercial Bank that provides individual loans to clients who have taken at least two group loans, have paid them on time and therefore have established a strong credit history. Grameen Leasing in Bangladesh offers a similar experience tested for over five years with an excellent repayment record. These two examples offer important lessons regarding credit risk management in an environment without traditional commercial bank requirements.

Box 10. Eligibility Criteria for Grameen Leasing Programme
(Asif Ud Dowla, 1998)

- A member must be at least a three-time loanee.
- A member must have an additional source of income so that instalments can be paid.
- Lessee or a member of the family must have prior experience in managing the leased item, and the member of the family must oversee the item.
- In the case of transport items, lessee or a member of the family must be an experienced and licensed driver.
- Leased item must be used properly and the repayment rate must be satisfactory.
- A member must have a space or will create an appropriate space to store the leased item.

5.2.3 Speed of Processing and Access

Processing applications should take the least time possible without compromising the position of the lessor. In addition, the lessor should ensure that once applications have been approved, money is available to finance the acquisition of the asset. One of the arguments advanced in favour of leasing is that it normally takes a shorter time than conventional bank financing between submission of the application to disbursement of funds and access to the asset. In Tanzania and Uganda, however, the processing time, especially for a first lease, is often as long as, if not longer, than that of conventional bank loans. Most financial institutions have a processing time of between one to two weeks, assuming that all the information has been submitted properly. EADB reported that some processing times ranged between 4 weeks to 6 months.

For example, ULC in Tanzania, after some bad experiences, decided to deliberately slow down the lease process time, particularly for a first time lease. This allows the company to evaluate the client by verifying the information that has been submitted and getting a feel for how serious and experienced the client is in their business. As one UCL official commented, “Unless you are in a very competitive market where turn around time is the key to survival, you do not have to adhere to a fast turn around time. You need to work with this person until you develop a level of comfort - a good gut feeling about him. Since we do not have credit bureaus, we do not have the information we need to make quick decisions. Haste makes waste”.

In contrast, Selfina and DFCU Leasing take a relatively short time to process lease applications, again assuming that all the required documents are submitted. However, short processing time does not guarantee that the client gets immediate access to the equipment. In the case of Selfina, which can process and approve a lease application in as short as one to two weeks, clients were waiting for up to a year to finally acquire the equipment. Selfina is facing a liquidity constraint that prevents it from being able to finance all the leases that it approves when it approves them.

Processing repeat lease contracts tends to be much faster since the leasing company already knows the client well. Disbursement of funds for purchase of equipment is also quicker after the first time. A DFCU client indicated that it only took four days for his second lease agreement to be processed. This processing time is consistent with the preferences of lessees who want a fast processing time and quick access to assets. A product attribute ranking exercise with potential lessees revealed that in a more competitive environment, delayed or slow access would be adequate reason for clients to seek an alternative source of financing.

5.2.4 Appraisal

Leasing companies use the appraisal process to establish the lessee's ability and willingness to pay. The clients who make it through the initial selection then move forward to the appraisal phase. The appraisal process leasing companies take their potential clients through is extremely rigorous and is the main mechanism through which the company assures itself that the potential client is worth the risk. Not only do staff have to perform a desk evaluation of the business through reviews of the client's bank statements, historical business performance data, cash flow projections and so on, staff also have to visit the business premises to verify the existence of the business and to get a feel for whether the operation is being run in a sound manner. Interviewing the businessperson and visiting their premises helps to verify whether the applicant has the ability and willingness to pay the lease instalments. This appraisal methodology differs from the approach used by MFIs where there is a heavy reliance on co-guarantors or members of the solidarity group, particularly in those MFIs that use the solidarity group lending methodology to vouch for the borrower. However, given the large loan sizes, an institution interested in establishing a leasing operation will have to invest in training staff execute thorough business appraisals, if they are to protect their funds.

Leasing companies charge an appraisal fee of between 1.5-3% of the lease value to cover the overhead costs incurred in carrying out appraisals. For typical micro-leasing clientele, the costs of performing an appraisal similar to that of larger operators would be prohibitive if not impossible especially given that most micro-enterprises fail to maintain the level of information currently required by lessors. It will therefore be important to develop simple but effective appraisal procedures for this market niche.

5.2.5 Approval

A number of leasing companies use a tiered approval system. Usually it is a three-tier system where designated individuals of increasing authority grant approvals based on the size of the lease. For instance, a management committee comprised of the Managing Director, the General Manager and the Chief Financial Officer can be assembled to approve the lower level leases. The next approval level can be an Executive Committee comprised of the Managing Director and a member of the Board. The final approval level is at the board level, for the highest bracket of leases. The institution makes an internal decision on what the caps are for each level of approval. This multi-tiered approval system enables quick disbursement while minimizing risk.

While approvals should be carried out with efficacy, it is just as critical that disbursement – the purchase and installation of the equipment for the lessee – take place in the shortest time possible.

5.2.6 Selection and Procurement of Asset

Selection and procurement of assets should be left to the discretion of the lessee. The lessor should simply facilitate the immediate payment to the vendor for the equipment the lessee has selected. A number of East African financial institutions promoting asset financing have made the costly mistake of getting too involved in the selection and procurement of assets. In addition to considerations of where to store the assets once the institution had procured them, in most instances the equipment did not meet the clients' expectations in terms of specifications and performance. In a lot of cases, the clients felt that the asset financing company should take responsibility for any losses resulting from inappropriate equipment. This ultimately increased the rate of default costing the lessor more money. SIDO in Tanzania reported paying dearly for this mistake, a sentiment that was echoed by a representative of Swiss Contact in Uganda (see Box 11).

Box 11. Get Not Entangled in Equipment Selection
"Allow the customer to select his equipment and give it a technical assessment as part of the approval. Ignoring this will cause you problems if ever the equipment fails," explained Mr. Bachu.

Swiss Contact, in partnership with the Uganda Small Scale Industrialist Association, was running a programme supporting carpenters with skills training and tools. Swiss Contact selected and procured inappropriate, used carpentry tools and equipment from Europe on behalf of the carpenters. The imported equipment was designed for working with softwoods, whereas the Ugandan carpenters were working with hardwoods. The equipment broke down within three to six months of use. In addition, even though the voltage was correctly calibrated (220V) the cycles were 50Hz instead of 60Hz. This resulted in burning out the motors, and the damage was often irreparable.

All current players in the leasing industry have adopted a policy of letting the lessee chose the equipment. Many leasing companies prefer lessees to purchase assets on the local markets rather than import them. This allows the lessor's technical experts to perform a basic technical evaluation to verify that the equipment is in good working order. Should there be a problem with the equipment, the local supplier can easily replace it. Once the lessor is satisfied with the equipment they request an invoice from the vendor, disburse a cheque to the vendor, and finally the equipment is released to the lessee while it remains the property of the leasing company.

In the case where clients have an overwhelming demand for certain assets, such as freezers and fridges, Selfina Ltd. has found it more cost effective to buy the items for the applicants. This earns them a volume discount, which is passed on to the clients in the form of lower monthly payments.

5.2.7 Mode of Disbursement
Leasing companies disburse a cheque directly to the vendor as payment for the equipment to guard against a diversion of funds. Many lessees corroborate the position of the lessors, preferring direct payment to the vendor to safeguard against misused funds. Some clients prefer a cash disbursement because they feel they can negotiate a cheaper deal on the equipment and use the remaining money for other purposes. However, many lessees have found that for working capital it is generally more sound to disburse the money directly to the vendor (see Box 12).

Asset financing relies on the ability of the asset to generate the required income in order for the operator to make repayments. It is therefore important that the operator gets good quality equipment that can be put to immediate economic use. Direct disbursement to the supplier facilitates the ease of asset acquisition.

Box 12. Give Me An Asset – Money is Fungible
Michael, a young Tanzanian entrepreneur, borrowed a bank loan to purchase a business asset. On his way home that evening he met his younger brother. "I have a problem I need to discuss with you," his brother said. "Why don't we have a drink and talk it over," Michael suggested as he led his brother to a nearby pub. Several drinks later Michael settled the bill and helped out his brother using some of his loan money.

The next morning, Michael headed upcountry to visit his parents. He secreted his money in what he thought was a safe hiding place and departed. In his absence, his family came across the money and used some of it to meet some household needs. On his return, Michael discovered that more than half of his loan had been diverted from its intended use. He could not top up the remaining money to purchase his asset, and to this day, he has not been able to purchase the asset.

With the wisdom borne of hindsight, Michael cautioned us "…never give cash! There will always be demands on it. Give the asset if you want to give asset financing".

5.2.8 Place and Mode of Payment

In Tanzania and Uganda, asset-financing institutions accept lease instalment payments either in cash or by post-dated cheques written for the entire lease term. In Uganda, where it is a criminal offence to bounce cheques, leasing companies require the lessee to write post dated cheques for the entire lease term and leave them with the institution. Whenever each instalment payment falls due, the leasing company deposits a cheque into its account. This approach is a good deterrent against delinquency because, should the lessee bounce a cheque, they would be liable for court action and they would have to pay the bank and the leasing company a penalty fee for the bounced cheque. However, for typical micro-leasing clients, many of whom do not have a bank account, this is not the optimal mode of payment. Insistence on cash payment seems to be the popular alternative to cheque payments.

5.2.9 Follow-up and Collection on Problem Accounts

It is imperative that institutions involved in asset financing have daily information on account status to ensure that any account problems can be identified and followed up immediately. There should be stringent action taken against delinquent accounts to prevent poor portfolio performance. Monitoring and follow-up is critical in the leasing industry. Institutions that intend to go into micro-leasing need to invest in an management information system (MIS) that gives the daily status of accounts. The leasing companies in East Africa have a quick response time to accounts that are past due. In most cases if an account is past due by one day, communication is immediate through a phone call to investigate why the client is in arrears. Once this initial follow-up has been made, the lessee is given a limited period to pay the amount outstanding to the leasing company. The leasing company can also impose a late payment penalty. Usually, the leasing company will begin intensive follow-up activities within 7-14 days of a missed payment. Most leasing companies will tolerate a maximum of only 3 missed instalments, after which they will repossess the asset and make arrangements for its sale.

Box 13. In Pursuit of the Money

CERUDEB underscored the importance of demonstrating to clients the seriousness of the institution vis-à-vis delinquent clients. According to Dirk van Hook, CEO of CERUDEB, "It's really important to instill discipline among clients. When we first opened our branch in Mityana, one client was late with his first payment. We threw him in jail for three days."

Martin Taylor of ULC in Tanzania echoed Mr. Van Hook's sentiment. "Clients have to understand their responsibility to the institution and you don't let them go. If a client has your money, you don't let them go, you've got to follow that money." Mr. Taylor cited the laxity in follow-up as one of the challenges Selfina was dealing with. The tension between trying to fulfil its development objectives, while trying to run a profitable business resulted in Selfina being quite easy on delinquent clients to the detriment of portfolio performance.

It is imperative that follow-up takes place immediately and the lessor takes action that will instil discipline among the lessees. If this is not done, clients will not feel compelled to repay (see Box 13). This translates into losses for the institution that is leasing. Selfina Ltd. has in the past experienced some problems with enforcing quick and strict follow-up on delinquent accounts, a situation that almost closed down the institution. Lessees gauge the response of lessors to incidences of delinquency and can take advantage where lessors are lax with enforcement.

5.2.10 Payment Incentives

Most asset financing institutions do not provide an interest rebate incentive to their clients. Few companies offer an incentive for early payment, such as interest rebates, though most levy a late payment fine on arrears. The only incentive for having good repayment record is immediate access to subsequent leases. In contrast, current and potential clients of formal financial institutions are keen to have a system that offers interest rebates for early payment. Leasing companies are reluctant to offer interest rebates because they argue that:

- A lease is a fixed-term contract that the lessee is obligated to honour and should therefore not seek to terminate early;
- Medium term financing enables the institution to make projections of income flows, which eases planning.
- Once the contract is signed, the lease income is considered part of the institution's cash flows for the duration of the lease.

5.2.11 Repossession of Assets
Repossession of assets from delinquent accounts should be enforced strictly so that lessees understand the seriousness of their obligation to the leasing company. Laxity with enforcing this policy could severely compromise the company's portfolio. Leasing companies have a policy concerning when repossession should take place. The standard practice among the leasing companies is that the asset is to be repossessed after 3 missed instalment payments. Some institutions repossess the assets within a much shorter timeframe.

Akiba Bank, for instance, repossesses the asset seven days after the first late payment. In many instances if the client is in arrears for the first time, the company may repossess the asset, and hold off on selling the asset in the case that the lessee is able to pay the requisite funds and continue financing the lease. In the case of problem clients, leasing companies generally begin the process of selling off the asset at its salvage value immediately in addition to recovering any other outstanding balances from the other assets that the lessee has pledged.

5.2.12 Legal Action
While there is provision for resorting to judicial action in cases where a lessee has failed to pay off a lease, most leasing companies are reluctant to take cases to court because it can take a year or longer for the courts to hear cases. Martin Taylor of ULC, explains, "When you seize the assets, you start the legal process because it can take as long as five years". In most cases, lessors opt to settle the breached contracts out of court. However, it is important that the lessor seek legal advice on how to go about the process of repossessing and selling off leased assets. While the asset remains the property of the lessor for as long as the lease has not been paid off in full and the title of ownership has not been transferred to the lessee, these assets are installed on the lessee's property. In Tanzania, there have been instances where delinquent lessees have sought injunctions citing trespassing to prevent lessors from coming onto their property to repossess assets. It is also critical that the lessor document all action taken with regard to accounts that are in arrears and the actions that were taken in response to that arrears status.

5.2.13 Auctioning - Liquidation of Assets
Because of the time and effort auctioning entails, most leasing companies hire auctioneers to liquidate repossessed assets. Auctioneers tend to take a 10% commission. However, DFCU does not use auctioneers to liquidate assets. In accordance with a policy to remain low-key about how bad debts are handled, they feel that if they auction off assets through auctioneers, using advertisements in the media, such action might have an unsettling effect on their clients. In this case, the institution uses its own resources to auction off assets. With the exception of Selfina, most leasing companies refund any amount of the salvage value in excess of the outstanding loan. Selfina stresses this during the one-day sensitisation seminar on the rights and obligations concerning the lease agreement. This process seemed clear to the clients interviewed.

The process of repossession and sale is often fraught with problems. Based on their experience, ULC recommends that lessors compile detailed documentation of the assets, including photographs, before and after they are repossessed and before any repairs are done in preparation for resale. It is common for some customers to go to court and claim that the asset was in good condition and that the leasing company and the auctioneers connived and sold the asset at a less than fair market value price, denying the customer a reasonable refund on the salvage value. Unless one has detailed documentation of the condition of the asset this can result in convoluted legal proceedings.

A level of liquidations is inevitable for any leasing company. Institutions providing leasing services have therefore learnt over time to restrict themselves to assets that are movable and easy to re-sell at an attractive price. Therefore, lessors tend to avoid leasing specialised equipment as well as equipment with a high obsolescence factor.

6.0 Strategic Considerations for Venturing into SME Leasing

There is a large demand for asset financing among micro- and small enterprises. Current leasing companies, MFIs and banks all have the opportunity to tap into this market. While there are general strategic considerations that any of these institutions would have to take into account, some considerations are peculiar to the specific type of institution involved. To evaluate their capacity to venture into micro- and small enterprise leasing, financial institutions including bank subsidiaries, leasing companies and MFIs must examine human resources and training needs, delivery channels, management information systems, risk management, product design, financial implications, legal and tax implications and social impact (Brand, 1998). This section will discuss these elements and how they relate to the different institution types.

6.1 Staffing and Management

Serving micro- and small enterprises requires an entirely different management and organisational approach from serving medium and large sized businesses. In order to create an appropriate organisational culture, the leasing company would need to either hire new staff or re-orient existing staff to serve this new clientele. These staff would need to be trained to appraise smaller loans, to make cash flow assessments, etc. It may be necessary to hire new staff as the existing staff may find it difficult to switch from working with medium sized businesses to micro- and smaller enterprises. The micro-leasing staff would be expected to handle larger client numbers in order to enable the unit to operate profitably.

Banks like Akiba and CERUDEB that already have varying degrees of experience with individual lending to micro- and small entrepreneurs might find it easier to start up a leasing unit. Initially, it may even be possible to start the unit with existing credit officers from within the institution. They would already have established some of the skills necessary for micro-leasing appraisal. On the other hand, banks that have no microfinance experience would start from a position similar to that of lessors going into micro-leasing for the first time. They may need to create a new and separate business unit with an organisational culture that is supportive of micro-leasing. They would also need to hire management staff with a good understanding of the micro- and small business sectors.

Considering the initial small volume of business likely to be generated by MFIs, the cost and the amount of institutional adjustment required to enable the MFI to carry out viable micro- and small leasing operations, as well as most MFIs' current struggles with capital constraints and sustainability, MFIs might be better advised to opt for a strategic partnership with a leasing company. The MFI would perform the initial appraisal and refer clients with asset financing needs to the leasing company. As mentioned earlier, this arrangement would mainly be viable for MFI clients who require costly assets that cannot be financed using current MFI products. Otherwise, MFIs wishing to go into leasing on their own would have to hire staff with leasing experience and with individual lending appraisal skills. In addition, these institutions would have to be prepared to face a steep learning curve to be successful in the asset financing business. According the ULC management, leasing is best practiced through an individual lending methodology, they strongly advise against putting it in a group context, such as used by MFIs that distribute small loans. This sentiment is corroborated by the experiences of MFI clients where group members are increasingly unwilling to guarantee loans that are beyond a certain size. In order for an MFI to take advantage of leasing in a worthwhile manner, it would have to finance slightly larger assets that are currently not effectively financed through a group lending mechanism.

6.2 Management Information System

A management information system (MIS) that can track client performance on a real time basis has been emphasized by most leasing companies in Uganda and Tanzania as critical for viable micro- leasing operations. This feature is crucial considering the need for immediate follow-up on delayed payments. The

MIS should be able to separately track, monitor and analyse the leasing portfolio. The MIS should also be able to handle accounting and portfolio monitoring and have the ability to produce daily portfolio aging reports. Most leasing companies already have what they feel are appropriate MIS systems though they might need to be customised in order to serve a different market segment. According to an expert with one of the leasing companies, developing a leasing MIS can cost as much as $30,000. There are some packages that can be purchased off the shelf but they are designed for a different legal and tax environment. Given this situation, EADB recommends that it may be preferable to design an MIS in house to accommodate local market peculiarities. In order to ensure an effective real-time MIS that is sensitive to the leasing legal and tax environment in the country, new entrants into the micro-leasing market need to hire leasing and MIS experts in order to make an informed decision between buying off the shelf software and developing an MIS in-house. As developing software in-house is expensive, management need to consider carefully if the prospective growth in the industry warrants the initial investment.

For MFIs, the MIS is just one of several major costs the institution would incur. As mentioned earlier, because of the prohibitive costs of start up as well as capacity considerations, a strategic partnership with a leasing company makes a lot of sense. The partnership would allow the MFI to take advantage of real-time MIS that already exists with the leasing company. This has worked reasonably well between Selfina and ULC in Tanzania where Selfina maintains its portfolio on ULC's system and therefore has access to MIS expertise.

6.3 Cost of Money and Liquidity Implications

Leasing ties up institutional funds for extended periods of time so an institution needs to ensure that leasing does not create a liquidity crisis that may affect other financial products.

Financial institutions considering leasing need to recognise that an effective leasing operation requires access to large amounts of affordable capital. Without adequate capital, leasing operations quickly develop a reputation for being unable to deliver. This may adversely affect repayment rates and trigger default since one of the main motivations for repayment among small and micro- borrowers is access to a subsequent loan or in this case leases. Selfina suffered from this situation. Clients viewed the institution as being unable to deliver on approved leases because of lack of adequate funds.

DFCU explains that lack of adequate funding is also a function of cost of money. As a deposit taking institution, they have observed that few East African depositors are willing to tie up their savings in long-term deposits and the few that are willing, demand very high rates. This translates into very high interest rates for most MSEs, most of which are operating on very narrow profit margins. It is because of this that some MSEs are unable to make repayments

If leasing is to become viable for the long-term, there is need for alternative sources of capital at concessional terms. To promote the growth of the industry, donors might have to consider making available concessional loans in the medium term.

6.4 Market Research and Pilot Testing

Leasing to the SME segment in East Africa is still a fairly new practice with little precedence. For any institution wishing to provide leasing on a large scale, market research is crucial. Market research and pilot testing will yield a lot of valuable information that will probably lead to redesigning elements of the product, its delivery system, MIS, staff training, operations manuals, marketing material, costing and pricing (Wright, 2000).

Market research helps institutions establish a deeper understanding of client needs and how they are currently meeting them. Market research enables these institutions to design leasing products that respond to the needs and preferences of the clients while producing a sustainable programme. Several of the leasing institutions missed this step of the product development cycle and paid dearly for it. For example, Selfina moved forward without a pilot phase leading to difficulties with their product and delivery systems, which cost Selfina a great deal in terms of time and money to correct.

Product concept testing discussions (see Wright, 2000a for a description of these and their role) with clients from various leasing companies revealed that leasing companies could retain many of the features of their current products if they move into MSE leasing. However, as mentioned before, further research would be necessary to develop simplified and less expensive appraisal processes and collateral substitutes. The lessor needs to develop other mechanisms of safeguarding risk such as the use of guarantors, or working in partnership with top-end MFI clients or business associations in the MSE sector.

MFIs need to acknowledge that their clients need asset financing (domestic or business) and are already financing assets using working capital loans. Market research is required to modify their products to be more responsive to their clients asset financing arrangements. A few MFIs already offer asset loans alongside working capital loans.

6.5. Tax and Regulatory Considerations

Laws affecting leasing vary from country to country. In Uganda and Tanzania, a range of laws relating to hire purchase, contracts, tax, etc, governs leasing. Legal counsel is crucial for any financial institution wishing to go into micro-leasing. Legal interpretation becomes particularly important when clients default, as cases are resolved in court, careful scrutiny of contractual terms and conditions is required (Euromoney Publications, 1995). An auctioneer working for a financial institution in Uganda informed the research team that most banks and leasing companies have been able to avoid legal battles during the repossession process because they are dealing with a legally ignorant public. However, Selfina reports that this is changing as illustrated by lessees occasionally keep loan officers off their premises with court injunctions for trespass.

Under the current regulatory and tax environment in Tanzania and Uganda, leasing companies are able to claim VAT (20% in Tanzania and 17% in Uganda) on assets and spread lessees VAT payments over the lease term through the instalment repayments. Banks are unable to claim VAT as they are not VAT registered and so cannot pass on any benefit to the customers. This gives leasing companies an edge over banks. In order to access the VAT exemption advantages, some banks like Stanbic in Tanzania, have established subsidiaries registered as leasing companies. In countries where the lessor can claim depreciation on the asset, it is even more attractive for banks to establish leasing subsidiaries since in this context the tax shield enables the lessor to offer significantly lower interest rates on the lease than they can as commercial banks.

MFIs are predominantly NGOs and thus are not VAT registered and subsequently are unable to claim VAT. MFIs could consider establishing a separate business unit. However, given the capital constraints, institutional limitations and sustainability challenges with which Ugandan and Tanzanian MFIs operate, this may not be feasible. The alternative is for the MFI to enter a strategic partnership with a leasing company that is already structured to take advantage of VAT exemption.

The regulatory and supervisory environment is under review in both Tanzania and Uganda. The team however was unable to establish the nature of changes anticipated. In Uganda however, the team of research consultants shared their terms of reference. Their objective was "to examine the current regulatory environment in Uganda as it relates to leasing, and identify obstacles which constrain the growth of the industry, particularly with regard to servicing SMEs. Having completed this analysis, the objective is to examine various different regulatory approaches and reforms that might result in lease financing being more widely accessible to, and cost effective for use by businesses especially SMEs, in Uganda, and make proposals on the best way forward."

The study aims are to prepare for the creation of a suitable regulatory environment involving, at minimum, the following:

1. That the rights and duties of each party are to be clearly stated;

2. Clear, simple and effective legal mechanisms are to be in place for reclaiming assets if the terms of the lease agreement are breached;
3. Appropriate tax and accounting regulations which ensure that lease financing is attractive to potential providers and users alike; and
4. Simplified documentary requirements, which ensure that SMEs can utilize lease financing at a minimum compliance cost.

6.6 Delivery Channels and Strategic Partnerships

Several options exist for financial institutions to penetrate the MSE leasing market and evaluate the appropriateness of an option as it varies by type of institution and country due to variations in regulatory provisions. This section discusses the options available to each type of institution based on their current structure, available resources, and the limitations of the legal and regulatory framework under which these institutions must operate. The discussion limits itself to the small enterprise segment as medium sized businesses have better access to both bank and lease financing and most micro-entrepreneurs are able to meet both their working capital and asset financing needs through modified MFI products. The discussion focuses on potentially viable arrangements for each institutional type given the considerations presented in previous sections of the report.

6.6.1 Options for Leasing Companies

Peter Roussos and David Ferrand (1999) argue reliance on non-traditional collateral, mobilisation of local knowledge, rapid loan appraisal and strong follow-up system have proved to be essential for minimization of transaction costs in individual lending. Respecting contextual variations, non-traditional collateral might include household or business items. However, non-traditional collateral is not a sufficient risk mitigation strategy. Careful screening of potential clients is required. Provident Finance in South Africa screens borrowers based on local knowledge of potential clients' ability, character and the state of the local economy. Provident uses local agents paid based entirely on a commission basis related to the repayment of borrowers. Traditional approaches used by banks to screen proposals based on analysis of historical performance and business plans are frequently inappropriate for MSE lending as these enterprises rarely keep records or are unable to produce reliable business plans.

For the lessor, the potential micro-leasing market can be split into 3 segments:

1. Current MFI clients requiring assets that cannot be financed with MFI loans;
2. Current clients of commercial banks; and
3. Small enterprises that need medium term finance.

Current MFI clients can be reached through strategic partnerships between leasing companies and MFIs whereby MFIs recommend their clients with asset financing needs that exceed their maximum loan amounts to leasing companies. This arrangement would reduce risks and screening costs for the lessor since the clients are carefully screened by the MFI based on an existing credit history. These clients would continue to access working capital loans from the MFI but would access asset finance through the lessor. The collection of lease instalments would be made through the MFI's already established system with the MFI earning a commission for its role as a collection agent for the leasing company. The arrangement would thus be mutually beneficial to both players. Such an arrangement has been negotiated between DFCU leasing and the Gatsby Trust in Uganda and will in many ways provide a precedent for other interested parties. PRIDE Tanzania has informally referred and introduced clients to Selfina.

Mark Havers reports that OLP in Pakistan have developed innovative linkages with other organisations (NGOs and businesses) who have parallel interests. Such linkages are a crucial innovation for reducing transaction and training costs and thus expanding outreach. In the NGO sector, for example, they have begun working with the Aga Khan Rural Support Programme (AKRSP), a major NGO working in the remote and mountainous Northern Areas of Pakistan. AKRSP introduces OLP to enterprises which have either graduated from their own microfinance programme, or which are too large to join in the first place. OLP make their own assessment and write the lease, but AKRSP facilitate collection of the lease repayments (Havers, 2000).

The second segment is those customers of conventional banks who are unable to secure medium term financing because banks do not offer it. Responding to the demand, some banks like CERUDEB in Uganda and Akiba in Tanzania have begun to offer medium term assets financing.

A third category of potential clients for leasing companies is the range of small-scale enterprises that currently lack access to any form of formal financial services. These enterprises lack credit references and may be unable to supply meaningful collateral making the risks of leasing to them relatively high. One way to reach this segment of the small enterprise sector would be through their associations, if they belong to any. Akiba Bank in Tanzania is currently using this strategy with its leasing product for taxi drivers. Associations would play a role similar to that of the credit-referencing role of the MFIs suggested earlier. Unfortunately, most associations of small entrepreneurs are relatively weak. The leasing companies need to research the dynamics that create cohesion among the various associations beyond the need for financing. For example, taxi association members provide mutual support against risks like being arrested. It has a fund used to hire lawyers and pay various fines. The association also protects members business from new competitors.

6.6.2 Options for Microfinance Institutions

While MFIs could choose to go into leasing on their own, this is particularly challenging given that most MFIs are not yet sustainable and lack the infrastructure and experience necessary for individual lending. Martin Taylor, Managing Director of United Leasing in Tanzania, advises, "It is always useful to get established players to do leasing… the marginal cost is lower because a lot of costs are defrayed. Most MFIs would need a lot of fresh spending to establish a separate department, recruit new staff and purchase or develop a customised MIS. They would also need long-term sources of financing at low interest rates. Given the magnitude of the investment required, a more viable way for MFIs to penetrate the leasing market would be through strategic partnerships with current leasing companies. The partnership arrangement could work in a variety of ways. One way would be for the MFI to negotiate a 50/50 risk sharing arrangement like that being finalised between DFCU and the Uganda Gatsby Trust. Under this arrangement, the MFI would put up 50% of the financing and the leasing company the other 50%. Initial appraisal and character assessment is done by the MFI. The leasing company does secondary appraisal and disbursement while the MFI does the collection."

In the event that leasing companies are reluctant to take on the risks of working with an unfamiliar market segment, the MFIs could lobby donors to provide a guarantee fund against which the lessors would be compensated for any losses incurred. The guarantee fund would be an interim measure with the long-term goal of MFIs developing sufficient credibility with lessors through which lessors would be willing to share the risk.

6.6.3 Options for Conventional Banks

Banks need to establish separate leasing subsidiaries in order to take advantage of VAT exemption. This is the route Stanbic Bank in Tanzania followed and one that several other banks in Uganda and Tanzania are giving serious consideration. Just like leasing companies without operational experience in the small enterprise sector, it may be strategic for the subsidiary to work in partnership with MFIs and clients from existing business associations to ease the process of character assessment and establishing client credit history. The other advantage in working with MFIs and existing business associations is that they have mechanisms that enable members to make periodic savings towards the, often large, initial deposit/down payment. Akiba Banks clients were able to assemble the deposit by organising RoSCAs whose proceeds were used by various members to make their down payment. However, the MFI should not encourage the creation of new associations in order to access finance as Uganda and Tanzania are awash with failed attempts to do this.

Box 14. Akiba Bank and the Taxi Operators Association
"Akiba Bank explained to us," narrates an Akiba client, "that in order to get a loan we must be recommended by the association, be guaranteed by the association and raise a down payment of 25-40%. Although I did not find it hard to be recommended and guaranteed by the members, it was difficult to get the down payment. So I organised a *kibati* (RoSCA). In this way many of us eventually raised enough money to make the down payment for the car."

7.0 Filling The MSE Finance Gap – What Can Donors And Government Do?

7.1 Long-term Funds, Guarantee Funds or Equity Investments

Lack of medium and long-term financing is one of the biggest hindrances to the development of leasing. Martin Taylor, Managing Director of ULC explains that most financial institutions and investors focus on "safer" short-term investments especially Treasury Bills. Donors can fill this gap by making medium and long-term loans to leasing companies, providing loan guarantees to reduce the perceived risk and/or participating in equity guarantee funds. They can finance the provision of technical expertise, leasing awareness campaigns and lobby for an enabling policy and regulatory environment. However caution should be exercised in designing guarantee funds because global experiences have been very mixed. Guarantee funds are difficult to establish and are subject to protracted negotiations. If established within the donor agency, guarantees frequently present difficulties with respect to donor's internal accounting practices, typically relating to contingent liabilities, advancing cash in advance of need and in recognition of fee income. If established external to the donor, an appropriate management arrangement has to be developed. In either case, the design has to address potential moral hazards related to the guaranteed party not developing appropriate screening mechanisms, knowingly undertaking suspected unviable lending, or not properly pursuing defaulters knowing that loan default can be recovered through a guarantee.

Selfina Ltd. and Network Leasing Company (NLC) in Pakistan provide an example of concessionary funding arrangement. Mark Havers reports that in March 1996, NLC received a loan of ChF.750,000 and a technical assistance grant of ChF.200,000 from the Swiss Agency for Development and Co-operation (SDC). The loan was used to directly fund leases made by the company from its head office in Karachi while the grant was used for institutional and product development within NLC. NLC's performed well in repaying the SDC loan, in developing its institutional base and in reaching the target groups agreed upon with SDC. As a result, late 1998 saw SDC extend a further loan (this time of ChF.1 million for five years at 17%) to NLC, along with a smaller (ChF.100,000) technical assistance grant. Both loan and grant were specifically to assist NLC in establishing leasing operations in Pakistan's North West Frontier Province. Both SDC loans were convertible into equity at SDC's choice, but neither has been at the present time.

Since MSEs are commonly seen as high risk and costly to service because of the reasons discussed, government and donors can help mitigate the problem by sharing in the risk through participation in a guarantee fund. A mixture of donor grants and loans, government funds, and contributions by commercial banks, and other interested investors could capitalise the guarantee fund. The risk sharing created by the guarantee fund would ideally entice conventional leasing companies to increase lending to SMEs based on their limited collateral and their performance record. The guarantee fund should be managed by a private sector entity and should be used to underwrite lease purchases (Sander, 2000).

7.2 Technical Assistance for Leasing

Donors can fund technical assistance to aid in the transfer of skills and to adapt techniques of leasing from the more experienced markets. Selfina Ltd., with the help of DFID has already tested this approach with technical expertise being provided by ULC.

Leasing companies like ULC and DFCU, currently doing larger scale leasing, are interested in "moving down market" to MSE leasing. Modest amounts of technical assistance for internal capacity building and organisational culture re-orientation may help them to make the change, with the added incentive of subsequent concessionary loan funds if they are successful (Havers, 2000).

7.3 MSE Awareness

Donor agencies should assist the strengthening of leasing by MSEs by supporting awareness programmes, seeking to educate MSEs as to the benefits and obligations of leasing. This is especially true in Tanzania where Martin Taylor, Managing Director of ULC, believes this to be a big need. Selfina Ltd. attributes improvements to its portfolio and reduced default rates to awareness seminars during which the rights and obligations are clearly articulated before the client proceeds with processing an application. Similarly the Leasing Association of Pakistan runs awareness programmes, which are reported to be mutually beneficial for both the lessee and lessor.

7.4 Facilitating Linkages with Microfinance Institutions

MFIs that elect to link their higher-end borrowers seeking asset financing to leasing companies. Donors could facilitate workshops and finance technical assistance that would bring all parties together to discuss the mutual benefits and strategies for MFI and leasing companies working in partnership. UNIDO has already started doing this by linking Uganda Gatsby Trust Clubs and DFCU Leasing.

Lastly, there will be a need for continuous quality improvement in order to refine the art of asset lending to MSEs. Some of the lessons from Bolivia, Pakistan and South Africa will need to be learned, but not blindly replicated. The process of adaptation needs to be deliberate and systematic with full sensitivity to the unique and peculiar environment to avoid the costly pitfalls that have often come with the "acquired innovativeness deficiency syndrome" which has almost permanently impaired several East African institutions.

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APPENDICES

Appendix 1: Glossary of Leasing Terminology

Assign To transfer or exchange future rights. In leasing, the right to receive future lease payments in a lease is usually transferred to a funding source, in return for up-front cash. A lease assigned by the lessor to a funding source is called an assigned lease.

Broker A company or person who arranges lease transactions between lessees and lessors for a fee.

Bundled lease A lease that includes many additional services such as maintenance, insurance and taxes that are paid for by the lessor, the cost of which is built into the lease payments.

Bargain purchase option A lease provision allowing the lessee, at its option, to purchase the leased property at the end of the lease term for a price that is sufficiently lower than the expected fair market value of the property, such that exercise of the option appears, at the inception of the lease, to be reasonably assured.

Conditional sale contract An agreement for the purchase of an asset in which the lessee is treated as the owner of the asset for income tax purposes (thereby being entitled to the tax benefits of ownership, such as depreciation), but does not become the legal owner of the asset until all terms and conditions of the agreement have been satisfied.

Casualty value A schedule included in a lease which states the agreed value of equipment at various times during the term of the lease, and establishes the liability of the lessee to the lessor in the event the leased equipment is lost or rendered unusable during the lease term due to casualty loss.

Commitment letter A document prepared by the lessor that sets forth its commitment, including rate and term, to provide lease financing to the lessee. This document, if utilised, precedes final documentation, and may or may not be subject to lessor credit approval.

Discounted lease A lease in which the lease payments are assigned to a funding source in exchange for up-front cash to the lessor

End-of-term options Options stated in the lease agreement that give the lessee flexibility in its treatment of the leased equipment at the end of the lease term. Common end-of-term options include purchasing the equipment, renewing the lease or returning the equipment to the lessor.

Economic life of leased Item The estimated period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease.

Executory costs Recurring costs in a lease, such as insurance, maintenance and taxes for the leased property, whether paid by the lessor or the lessee.

Equipment schedule A document, incorporated by reference into the lease agreement, that describes in detail the equipment being leased. The schedule may state the lease term, commencement date, repayment schedule and location of the equipment.

Equity investor or participant An entity that provides equity funding in a leveraged lease transaction and thereby becomes the owner and ultimate lessor of the leased equipment.

Financial institution lessor A type of independent leasing company that is owned by, or a part of, a financial institution, such as commercial bank, thrift institution, insurance company, industrial loan company or credit union.

Full payout lease A lease in which the lessor recovers, through the lease payments, all costs incurred in the lease plus an acceptable rate of return, without any reliance upon the leased equipment's future residual value.

Full-service lease A lease that includes many additional services such as maintenance, insurance and property taxes that are paid for the lessor, the cost of which is built into the lease payments.

Fair market value The value of a piece of equipment if the equipment were to be sold in a transaction determined at arm's length, between a willing buyer and a willing seller, for equivalent property and under similar terms and conditions.

Finance lease From a financial reporting perspective, a lease that has the characteristics of a purchase agreement. Such a lease is required to be shown as an asset and a related obligation on the balance sheet of the lessee.

Initial direct costs Costs incurred by the lessor that are directly associated with negotiating and consummating a lease. These costs include, but are not necessary limited to, commissions, legal fees, costs of credit investigations, the cost of preparing and processing documents for new leases acquired and so forth.

Investment tax credit A credit that a taxpayer is permitted to claim on its national tax return (a direct offset to tax liability) as a result of ownership of qualified equipment.

Lease broker An entity that provides one or more services in the lease transaction, but that does not retain the lease transaction for its own portfolio. Such services could include finding the lessee, working with the equipment manufacturer, securing debt financing for the lessor to use in purchasing the equipment and locating the ultimate lessor or equity participant in the lease transaction. The lease broker is also referred to as a packager.

Lessee The user of the equipment being leased

Lessor The owner of equipment which is being leased to a lessee or user.

Leverage lease A specific form of lease involving at least three parties: a lessor, lessee and funding source. The lessor borrows a significant portion of the equipment cost by assigning the future lease payment stream to the lender in return for up-front funds (the borrowing). The lessor puts up a minimal amount of its own equity funds and is generally entitled to the full tax benefits of equipment ownership.

Maintenance contract An agreement whereby the lessee contracts with another party to maintain and repair the leased property during the lease term, in exchange for a payment or stream of payments.

Master lease A lease line of credit that allows a lessee to obtain additional leased equipment under the same basic lease terms and conditions as originally agreed to, without having to renegotiate and execute a new lease contract with the lessor. The actual lease rate for a specific piece of equipment will generally be set upon equipment delivery to the lessee.

Net lease A lease in which all costs in connection with the use of the equipment, such as maintenance, insurance and property taxes, are paid for separately by the lessee and are not included in the lease rental paid to the lessor.

Non-cancellable lease A lease that is cancellable only: (a) upon the occurrence of some remote contingency, (b) with the permission of the lessor, (c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor, or (d) upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.

Non tax lease A type of lease in which the lessee is, or will become, the owner of the leased equipment, and therefore, is entitled to all the risks and benefits (including tax benefits) of equipment ownership.

Off balance sheet Any form of financing, such as an operating lease, that, for financial reporting purposes, is not required to be reported on a firm's balance sheet.

Operating lease From a financial reporting perspective, a lease that has the characteristics of a usage agreement. It is not required to show this type of lease on the balance sheet of the lessee.

Purchase option An option in the lease agreement that allows the lessee to purchase the leased equipment at the end of the lease term for either a fixed amount or at the future fair market value of the leased equipment. A typical lease in Uganda and Tanzania has an automatic purchase option.

Re-marketing The process of selling or leasing the leased equipment to another party upon termination of the original lease term.

Sale-leaseback A transaction that involves the sale of equipment to a leasing company and a subsequent lease of the same equipment back to the original owner, who continues to use the equipment. Selfina Ltd in Tanzania has this as a fraction of its portfolio.

Skipped-payment lease A lease that contains a payment stream requiring the lessee to make payments only during certain periods of the year. This is practiced by United Leasing in Tanzania.

Step-payment lease A lease that contains a payment stream requiring the lessee to make payments that either increases (step-up) or decreases (step-down) in amount over the term of the lease.

Ticket size Refers to the cost of equipment being leased. The leasing market place is roughly segmented into the small, middle and large ticket markets.

True lease Another term for a tax lease where, for tax purposes, the lessor qualifies for the tax benefits of ownership and the lessee is allowed to claim the entire amount of the lease rental as a tax deduction.

Upgrade an option that allows the lessee to add equipment to an existing piece of leased equipment in order to increase its capacity or improve its efficiency.

Useful life This is the period over which a depreciable asset is expected to be used by the enterprise

Appendix 2: Product Comparison Matrices

Product Comparison Matrix - Uganda

	Gatsby Trust/UNIDO	**DFCU Leasing**	**Centenary Bank**	**EADB**	**UWFT**	**UMU**
Product (Design)	Finance Lease	Finance Leasing	Investment Credit	Finance Lease	Asset Financing Loan	Capital Asset Loan
Purpose	Asset financing for small & medium enterprises (SMEs)	Asset financing for medium to larger businesses	Asset financing and working capital	Asset Financing	Business Asset Finance	Assets but reported to be used for working capital
Profile of Target Clients	Asset financing for small scale manufacturers (SMEs)	Individual as well as companies, Going concern looking to expand, seeking medium with strong cash flow – high demand among multinationals	Owners of small and medium businesses (a year old) and institutions – like schools	Companies with no more than 30 employees with assets not more than $100,000	Profile – women entrepreneurs in groups or individual basis	Individuals within groups beyond 4^{th} cycle. Group must have no record of late payments. Individual outside of group mechanism can access this CAL
Exclusive source	Multiple sources Allowed	Multiple sources allowed	Multiple sources allowed	Multiple sources allowed	Yes	Exclusive , Can service both WC and CAL
Speed of processing	N/A because programme has not started yet	2 weeks	1 week if all requirements are submitted for below 29 million. Other go the board	4 weeks to 6 months – for large loans need board which meets every quarter ($400,000)		3 days
Collateral	20% lease amount plus the asset	Asset, 15-20% deposit plus additional security	Asset, existing business assets, chattel, etc	15-25% of asset value, plus additional security	15% of loan value	20% of amount
Guarantors	No need for guarantee	Directors	Guarantor – with accounts at CERUDEB, person of good repute	Company directors	Group for group based loans	Group of five members

	Gatsby Trust/UNIDO	**DFCU Leasing**	**Centenary Bank**	**EADB**	**UWFT**	**UMU**
Deposit/Down-payment	20% deposit of lease amount	15%-20% deposit	25% equity	15-20% deposit	15% deposit/savings	20% deposit/savings
Selection of Asset	Lessee selects asset	Selection is by lessee but must be approved by DFCU – the supplier knows the business – we keep a arms length	Customer, loan officer may inspect vehicle	By lessee – identifies vendor	By client	By client and payments are made by the client
Preference of New over used equipment	New equipment – programme requirement	Use both	No preference but must be in good condition	New preferred but room for used but needs a lot of examine for lack of manufacturers guarantee for economic reasons	Client preference	It is up to the client and the group members.
Duration of loan/lease	12-36 months	24-60 months	6- 12 months but adjustments are being made to accommodate 24 months	12-60 months	3-9 months	7 – 12 months
Frequency of Repayment	Fortnightly or Monthly depending on consensus of group	Monthly to Quarterly – weekly has high administrative costs	Monthly but we have allowed schools to use each term	Monthly, 3 monthly, quarterly depending on type of business	Weekly	Monthly because of the administrative convenience and man power limitations for very frequent transactions
Flexibility of payment	None	Respond to seasonality	Yes, see above	Responsive to seasonality	None	Monthly all equal regardless
Grace Period	Locally procured assets – 3 months; overseas procured assets – 4 months	None	Grace period to agriculture ranging from 1- 7 months	None	None	None

	Gatsby Trust/UNIDO	**DFCU Leasing**	**Centenary Bank**	**EADB**	**UWFT**	**UMU**
Amount (Range)	Individuals- maximum of Ush.10M	10 – Million Maximum $5500,000? Average $25,000 to $150,000	100,000/= to 1 billion, average loan size 1.2 million	$20-80K averaging $50K	Individual loans for 500,000 to 3 million	300 – 1million 1m – 4 million
Access Requirements	• Member of Gatsby Trust for 6 months • Operating enterprise • Industry trading license • Member of peer group • Deposit 20% of lease amount w/club • Viable business plan • Joint liability (group lease) • Registered association (group lease)	• Participation in Sensitisation meeting • Preliminary project meeting • Deposit • Articles and Memorandum • Certificate of incorporation • Audited Accounts • Pro-forma invoices • CVs of directors • Bank Statements	Must own a business for over a year Acceptable Security, machinery, land title	• Memorandum and articles • Profile of ownership and management set up • Audited and management accounts • Technical specs, cost and supplier of asset • Terms and conditions of supply of assets • Site of operation • Brief business plan	**Group** • 80% of group members must be women • Female executives • 10 – 30 members • 15% of loan saved as security • Savings account with UWFT • 6+ months in business **Individual** • Saved with UWFT for a week • be within a radius of 25 km of UWFT • 15% of loan as security • in business for 6+ months	• Member of group with no default record. • Record is cleaned if they borrow clean for six times • Member who have completed six loan programmes • 20% of loan in savings • Individual loans are extended provided with a strong guarantor
Maintenance	Lessee	Lessee must service equipment	Client	Lessee	Client	Client

	Gatsby Trust/UNIDO	**DFCU Leasing**	**Centenary Bank**	**EADB**	**UWFT**	**UMU**
Price						
Interest Rate	32% declining balance	Current rate 20- 24% but varies with TB rate	22% per annum declining balance, If you have over 3 loan on time payment – automatic loan 2% commission .5% monitoring 22% per annum	Cost of fund plus 5%, declining,	2.5% per month, flat	4% per month declining balance, but early payment does not earn rebate, loans settled earlier than 6 months do not earn graduation to next loan
Application fees	Ush.10,000		Ush.5,000 application form	None	2% loan commission	Membership fee, 5000/=
Appraisal fee	2% prior to disbursement of funds	1.5% Commission	None	2% paid upfront of estimated cost, refunded if application not approved. If it is approved but client does not accept, it is non-refundable		Processing fee – 3% + transport cost for officers (500/= to 3,000/=)
Other fees	Processing fee (successful apps. Only) 2%		None2% acceptance commission, 2% monthly monitoring fee	All procurement related costs are absorbed by lessee	Loan insurance = 1% of loan amount 5000/= Stationary	
Late Payment Penalties	0.5% per month	Early Payment Penalties, - varies and negotiated, 60,000 or 1% of rental amount whichever is bigger	0.5% of the loan amount, when penalty accumulates to 5% of principle the penalty stops	1.5% on late instalment	None	1,000/= penalty for late payment on same day but do not get red mark, a day late simply earns a red mark

	Gatsby Trust/UNIDO	**DFCU Leasing**	**Centenary Bank**	**EADB**	**UWFT**	**UMU**
Insurance	To be determined	Comprehensive insurance with selected company 3%- 6%	NO need, loan already insured	Comprehensive	1% of loan amount	Not applicable
Payment Incentives	Interest payment reduced because of declining balance?	None – instead there is a penalty	Waive of interest on accelerated loan payments, declining balance	Interest reduced on prepayment provided one seeking a larger loan	None except getting follow on loan	Obtaining next loan, Interest not reduced on early payments
Mode and place of Disbursal	Cheque disbursed directly to supplier; overseas procurements – letters of credit in favour of the supplier	Cheques written to supplier	Cheque written in favour of supplier	Cheque written directly to suppliers	Cash given to client	Cash to client at UMU Branch office
Place and Mode of Payment	Post-dated cheques with DFCU leasing	Bank with Post – dated check is pre-dominant, standing order for a few multinational	Cash and post-ated checks at entenary Bank	Standing order for dollar denominated accountable, no post dated checkedPost dated checks written once the average TB rate has been calculate	Cash at UWFT branch	Cash and checks at UMU branch
Process						
Sensitisation	UGT credit manager	Walk-in plus contacts through suppliers	Advertising	Walk-ins plus targeted visits to potential suppliers and client, community visits	Branch Office and community visits	Branch Office

	Gatsby Trust/UNIDO	**DFCU Leasing**	**Centenary Bank**	**EADB**	**UWFT**	**UMU**
Appraisal	Stage 1 - Club loan committees; Stage 2 – UGT Credit Manager	By leasing executives	Loan officer	Review at department level – 2 weeks to determine need for appraisal	By group and Credit Officer	Group and Credit Officer
Approval	UGT loans committee	Leasing committee	Branch Loan committee, (>4 million) Head office for subcommittee (4-10 million) High Committee (10-29 million) Board of Director (29+ million)	Ask for 2% commission to commence appraisal – monthly approval meeting.	Credit Officer and Group	Group and then credit officer. Loans above 2 million approved by head HQ
Disbursement /Purchase	Cheque disbursed directly to supplier	Cheques disbursed directly to suppliers	Cash given to Customer	Disbursement – after deposit made	By cheque to supplier	Cash for disbursement
Payment	By post-dated cheque to the Gatsby offices	Post dated checks prepared for the entire lease period	Post dated checks	Standing orders for dollar denominated accounts Post dated checks (six months) for local currency accounts	Cash at branch	Cash at branch office

	Gatsby Trust/UNIDO	**DFCU Leasing**	**Centenary Bank**	**EADB**	**UWFT**	**UMU**
Collection on problem accounts	Lessee given one week to pay late instalment; pay penalty of 0.5% per month. Max arrears period = 3 months after which recover outstanding monies from securities.	After one month asset is withdrawn, but there is some flexibility depending also the banking relationship	Immediately the day after	Response invoked after 14 days past due date,	Credit Officer and Group	Credit Officer
Repossession	By UGT	Repossession after one month – cash guarantee is usually enough to cover repairs	Court action a problem can take a year. Auctioneers frequently used.	After 2 missed instalments we repossession. Once a client is late by 2 he is unlikely to recover	By group	By group since they are the owners
Legal	Intervention of lawyers to ensure recovery of assets		Rare	Provided for but so far not used	Rare	Not applicable
Auction/ Liquidation	Auctioneers used to sell off repossessed items. Fees charged deducted from proceeds of sales.	Rarely use auctioneers for fear of run on company. A lot of is relationship banking	Auctioneers	Auctioneers are used to sell but need for care and transparency	Sell by group	Sell by group

Product Comparison Matrix – Tanzania

	Selfina	**Akiba**	**ULC**	**Supreme Furnishers**	**SIDO**	**MEDA**	**PRIDE**
Product (Design)	Finance Lease	Finance Lease & Cash loan	Finance Lease	Lease Purchase	Financial Leasing	Cash Loan	Cash loan
Purpose	Asset financing financing for micro-entrepreneurs	Working capital for micro-enterprises & asset financing for taxi drivers	Asset Financing for Medium enterprises	Domestic items	Equipment and tools for SME	Working Capital	Working Capital
Use	Asset financing, Working Capital	Asset financing (for taxis), working capital	Asset Financing	Domestic as well as business purposes	Equipment acquisition and training	Working Capital plus occasional purchase of assets	Working Capital, Asset Acquisition
Collateral	Asset	Asset plus additional collateral	Asset plus additional collateral	Assets	Asset	Assets for individual loans	
Guarantors	2 guarantors plus husband if married	Group of 5 (centre); individual loans – security of 150% of loan amount	2 Directors of the companies	relatives and 3 friends with details including pay slips, telephone numbers	None. Local authorities were character references	1 to 2 guarantors	Group of 5 first & group of 50 second level
Deposit or Down-payment	15-30% for second time clients	25-40% down payment	Deposit of 30% on wards	Down payment of no less than 10%	20% down payment of loan/asset value	20% of loan amount in savings	25% of loan amount in savings
Duration of loan/lease	6,12,18 but 12 preferred. 18 months leases problematic	6 to 36 months years	Average 24 –60 months, average 36 months	6,12 , 15 and 18 months	3 to 36 months	8 to 15 months	6 to 24 months
Repayment Periodicity	Monthly	Weekly; monthly for individual; taxis weekly	Monthly but weekly or bi-weekly for the troubled accounts	Monthly	Quarterly, semi-annually or annually depending on	Monthly	Weekly

	Selfina	Akiba	ULC	Supreme Furnishers	SIDO	MEDA	PRIDE
					nature of business.		
Flexibility of payment	Straight equal payments with not responsive to seasonal fluctuations	Straight equal payments with no response to seasonal fluctuations in income.	Based on cash flow. Payments may respond to seasonality. Contact payments required monthly	No save for getting a Christmas break	Yes, but not responsive to seasonal cash-flow patterns	Some flexibility. Weekly, bi-weekly and monthly. No flexibility to accommodate seasonality	None, all equal and weekly
Grace Period	No	No	No	No	1-6 months	None	None
Loan/Lease Size	50,000 – 6,000,0000 (500,000 average)	140,000 - 15 million, Average is 1 million	Average lease is $50,000	300,000 to 2,000,000	10,000 to 6 million, average amount difficult to establish?	250,000 to 3,000,000.	50,000 to 5 million but only 148 are above 1 million
Access Requirements	Women only, existing business, attendance of one day orientation seminar	Taxis: Member of the Tanzania taxi drivers association, submit proforma invoice to Akiba, deposit of 25-40% to Akiba, guarantee by group of 6-7 centre members. training for 1 day, which are formed into a centre of 36,	Memorandum, articles, certificate of incorporation, company profile, profile and personal financial statements of directors, with photocopies of passport, audited financial statements for last six months, cash flow projects,	Introduction letter from employer or business license, photocopy of ID, proof of income – salary slip or bank statement, 4 relative and 3 friends as guarantors, at least 10% of values as down payment, instalment not to exceed 30% of income	Adult of 18 years, business premises with assurance of tenancy, viable project idea, registered business name, citizenship,	1 to 2 guarantors, training of 2 hrs a day for a week, 20% security deposit, pledged assets of 1.5 times the loan (only sell them off with client consent)	6 week training have existing business more than 6 months old pay membership fee? Belong to a group Savings up to 25% of loan amount,
Place of Disbursal	Payments are made directly to	Cheque directly to supplier;	Check directly to	Good picked up from store	Payments made directly	At MEDA central offices	Checks

	Selfina	**Akiba**	**ULC**	**Supreme Furnishers**	**SIDO**	**MEDA**	**PRIDE**
	vendor by check		vendors upon consent with lessee		to vendors		
Where do clients make periodic Payment?	Payments made at office premises, Trouble account payments may be made in field but preference is office	Akiba branch	Payment are made by cash, check at ULC offices. Up country clients make deposits to ULC account and fax in the deposit slip	Payment at the office	Regional Centres	MEDA offices	At PRIDE offices
Mode of Payment	Cash	Cash; cheques also acceptable for individual	Cash , check, post dated checks,	Cash no checks, no payroll deduction	Cash	Cash	Client get cheques while repayments are done in cash
Ownership	Retained until full payments. Asset is	Akiba retains ownership of taxis until all payments are made in full	Ownership retained by ULC until all payments are made	Transfers from Supreme after final payment	Transferred to lessee after final payments	Asset owned by client but is pledged to group	Asset owned by client but is pledged to group
Price							
Annual Interest Rate	23-30% flat	24-30% (flat rate)	23-28% (declining)	14-42 % (declining)	5-30% currently, declining balance	36% declining	25-30% flat
Application fees	2000	Individual – 10,000	None	No	None		1%
Appraisal fee	No	No	1.5% of lease value	No	None		None
Other fees	No	Commitment 1%, legal fees 1%, monitoring 1.5%	None	No	None	Technical service fee – 1.2% for first loan	

	Selfina	**Akiba**	**ULC**	**Supreme Furnishers**	**SIDO**	**MEDA**	**PRIDE**
						decreases to 0.6% on next loan if client has good performance	
Late Payment Penalties	26% on late instalment but stops at 2 months after repossession	25% of the instalment amount		No	5% on payment instalment past due	1% of instalment for every day late.	NA, because the group takes the risk and the need for this never arises
Payment Incentives	Next lease	Interest rebate on individual & taxi loans on the portion which one has paid in advance	Access to next lease	Yes, interest and insurance rebate,	Management may decide to write off all the interest outstanding, if one is taking another lease	Good clients get low interest rates	Quick graduation to the next loan, No interest rebates
Insurance	None, the risk is considered negligible	Comprehensive for taxis. case of death they cover the outstanding balance	Variable depending on risk assessment	8% of assets value	Yes, but varied and figure not available	None	Loan Insurance Fund
Process							
Information/ Sensitisation	1 hour of sensitisation once a week. Full capacity attendance	1 hour of sensitisation at Akiba	Individual discussions with investigation officers	Information obtained at Supreme outlet	Information at regional office	1 week orientation/training by Credit Officer	6 weeks before first loan at branch offices
Appraisal	By Operations Manager and Loan Officer	Individual loans by Credit Officer; taxi programme by the taxi drivers with credit officer	By investigation officer and general manager	Done at supreme outlet by manager	By staff at regional office	Done by Credit Officer	Group of 5
Approval	1st level by operations and	ACB credit committee for	Approval done at 3 levels of credit,	Approval at the branch outlet	Appraisal forms	Done by credit committee	Credit Office and group

	Selfina	**Akiba**	**ULC**	**Supreme Furnishers**	**SIDO**	**MEDA**	**PRIDE**
	loan manager, 2nd level by general manager, 3rd level by board if loan amount exceeds 6 million	individual and taxi;	MD and financial officer, BoD each with a ceiling		forwarded to regional board, letter of offer given, if client is affirmative contract signed,		
Disbursement /Purchase	Client identified merchandise, Selfina pays vendor and delivers to client.	Taxi: direct payment to vendor;	ULC directly pays vendor	Good available at stores.	SIDO identified asset, procured, transported and installed, commissioned, and trained	Branch office	Branch office
Frequency of Payment	Monthly payment	Weekly payment	Monthly but weekly for trouble leases	Payments are made monthly at office	Payments are made as per schedule at the regional office?	Weekly payment	Weekly
Collection on problem accounts	Done by Loan Officer on troubled	Credit Officer and/or group members	Outsourced from debtor collection company	Cash d to Supreme, day late you get a call from Credit Officer	Regional office staff, the issue warning for 1st and 2nd missed payments	Regional office staff	Group of 5 firt and 50
Repossession	Done by LO who engages guarantors who usually pay	Bank officer- go to centre leader who helps repossess after one missed payment	By brokers with ULC staff	If account is in arrears for 3 months and no refund at all after repossession	3rd missed payments evokes a repossession warning letter, 4th missed payment evokes a	Client surrenders pledged item to MEDA offices for safekeeping until loan is paid off	Repossession by the group to which assets are pledged

	Selfina	**Akiba**	**ULC**	**Supreme Furnishers**	**SIDO**	**MEDA**	**PRIDE**
					repossession		
Legal	No need because agreements are clear on ownership	No	Not much because ULC holds title until all payments are made unless defaulter contests sell price	Rare	Rare	Rarely use legal recourse	By group
Auction/ Liquidation	Use an auctioning company for 10% of realized	Auctioneers, wait for 1 week before auctioning off.	Done by auctioneers! The lessee must pay any balances outstanding after liquidation	Repossessed goods are displayed in bargain centre. They are sold off if customer fails to make token payment. No refund is given to borrower after sale.	Auctioned by regional staff	MEDA sells off pledged items w/ consent of client	By group

Appendix 3: Terms of Reference

Study on Financing Mechanisms of Micro- and Small Businesses for Small Assets: Potential for Development of Leasing Products

BACKGROUND

As part of the Training of Trainers Course in Market Research for Microfinance Institutions (see attachment), all participants are required to conduct three weeks of post-workshop fieldwork before they are certified. This proposal is designed to:

a) provide valuable information to the financial services industry as it seeks to understand the need and potential for micro-leasing in East Africa through examining the potential market in Uganda and Tanzania

b) provide two of the AFCAP participants with an assignment that will allow them to fulfil the certification requirements.

OVERALL OBJECTIVES

The overall purpose of the study is to assess the potential for MFIs and other financial service providers, in the East Africa region, to develop profitable and appropriate small and micro-leasing products. The aim is to develop an understanding of the desires, needs and capacities of poor households and businesses with regard to leasing small assets and with this determine the potential market for micro-leasing and the form micro-leasing products may take.

RESEARCH OBJECTIVES

- Assess the systems/methods/rules of SELFINA (Tz) from a client perspective
- Assess the systems/methods/rules of ULC (Tz) from a client perspective
- Assess the systems/methods/rules of DFCU Leasing (Ug) from a client perspective
- Identify other informal/semi-formal leasing products and assess them
- Assess the systems/methods/rules of selected Ugandan MFIs' products from the perspective of clients who have used them to finance business assets
- Assess clients' likes, dislikes and their suggestions for improvement
- Understand how business people in the community obtain cash in the informal sector for purchase of assets that require lump sums - for household assets, microbusiness assets and small business assets
- Categorise the types of assets leased by financial value, industry/sub sector and portability.
- Understand local terms/language for describing the leasing arrangement
- Assess the nature of demand for leasing products - for household assets, microbusiness assets and small business assets
- Compare the results of the above analysis with micro-leasing product proposals from Uganda Gatsby Trust/UNIDO

SPECIFIC TASKS

The field component of the study will be conducted in accordance with the methodology provided in *Annex 1.* Specific tasks will include:

- Finalising the work plan and conceptual framework for the study's data collection and analysis
- Reviewing of existing literature including SELFINA/Uganda Gatsby Trust/UNIDO reports and others from outside East Africa (e.g. Mark Havers on micro-leasing in Pakistan)
- Discussing with target households on their personal and business financial needs and how these are met at present.
- Discussing with these households on the advantages and disadvantages of using a leasing approach to financing small assets (perceived or based upon clients' practical experience). Where clients have direct experience with a micro-leasing product the consultants will explore the specific strengths, weaknesses, opportunities and threats of these products.
- Assessing the nature and an indication of the level of demand for micro-leasing products in the study area.

- Identifying any external determinants of this demand that may be useful in targeting micro-leasing products
- Developing recommendations for any key product features for institutions looking to meet the demand for micro-leasing services.

DELIVERABLES
- A report covering the following key issues:
- An assessment of the current formal sector leasing products available in Tanzania and Uganda from a client perspective
- An assessment of alternative financing mechanisms used by households, micro-businesses and small businesses to finance assets
- A categorisation of the types of assets leased
- A listing of local terms/language for describing leasing arrangements
- An assessment of the nature of demand for leasing products - for household assets, micro-business assets and small business assets including an analysis of where/how this is being met
- A brief comparison of the study's results with micro-leasing product proposals from Gatsby Trust / UNIDO and with existing products such as from Selfina, ULC, and DFCU Leasing
- Presentation to Austrian Bureau for Development and invited parties

TIMETABLE
It is proposed that the study will be conducted over the period January 29th to 2nd March 2001. Fieldwork will be conducted during the first 3 weeks of this period.

SAMPLING METHODS TO BE USED DURING THE STUDY
Sampling Strategy
The study will consider the following sampling strategies:
- SELFINA/ULC/DFCU clients (FGD & PRA)
- SELFINA/ULC/DFCU ex-clients (FGD & PRA)
- SELFINA/ULC/DFCU non-clients (FGD & PRA)
- MFI clients who have used loan products to finance business assets (FGD & PRA)
- Client recommended clients (chain) to identify who knows the most about a particular phenomenon (Individual In-Depth Interview)
- Extreme or deviant cases: outstanding successes or notable failures (Individual In-Depth Interview)

Recruitment Of Focus Group Discussion/PRA Participants
Interviewees in each focus group must be:
- Between 5-8 individuals
- Able to meet the research objectives
- Able to fit the desired categories e.g. level of wealth
- Have a reasonable knowledge of the subject
- Feel comfortable sharing the knowledge in group settings

APPROACH AND TOOLS TO BE USED IN THE STUDY
Secondary Data Review Of Selfina's Operating Data And Description Of Products
- Product description including terms and conditions
- Operating data examining and categorizing types of goods leased to date

Focus Group Discussions And Participatory Rapid Appraisal With:
- Staff of Leasing and staff of a selected MFI
- Clients of SELFINA/ULC/DFCU Leasing and of a selected MFI in Uganda
- Ex-clients of SELFINA/ULC/DFCU Leasing
- Non Clients within the SELFINA/ULC/DFCU operating area
- Clients of MFIs who have taken loans to finance business assets

- Micro-entrepreneurs in various locations in Uganda and Tanzania who have an understanding of how people finance assets that require lump sums in the absence of leasing

Participatory Rapid Appraisal Techniques To Be Used During The Research/Study

- *Financial Services Matrix* is useful in determining which financial services are used by which socio-economic or socio-cultural strata of society and why, and thus the potential for designing or refining appropriate leasing/financial services products.
- *Venn/Chapati Diagram* will allow the team to analyse financial service groupings/organisations within the community and their roles in providing lump-sums for business assets
- *Simple Attribute Ranking* will be used to understand the relative importance/desirability of features in a lease financing arrangement (e.g. for understanding the relative importance of different elements of the products – fees, interest rate, opening balance, term, grace period etc.)
- *Relative Preference Ranking* will be used to see how clients and potential clients perceive the different leasing and financial service providers and components of the financial services they provide.

Report Preparation

Final report that includes methods, coverage, findings and conclusions from study

Appendix 4: List of Institutions Involved in Study

Akiba Commercial Bank Ltd, Tanzania – A Commercial Bank
Selfina Ltd., Tanzania – A micro-leasing company
Small Industry Development Institution (SIDO), Tanzania – a recently ended government programme
Youth Self Employment Foundation Organization (YOSEFO), Tanzania – A microfinance institutions primarily dealing in loans
United Leasing Company (ULC), Tanzania – The largest leasing company in Tanzania
PRIDE Tanzania – The largest micro-credit company in Tanzania
PTF (Presidential Trust Fund Tanzania) – A micro-credit NGO
Supreme Furnishers Limited – A hire purchase company operating in Uganda and Tanzania
Simba Com – A leading supplier of mobile telephone both in Uganda and Tanzania
DFCU Leasing Ltd – The leading leasing company in Uganda- less that 5 years in business
Centenary Rural Development Bank (CERUDEB), Uganda – A commercial bank involved in microfinance
Uganda Microfinance Union (UMU) – A micro-credit NGO
AFSAT (IT), Uganda – An information technology company operating both in Uganda and Tanzania
Swiss Contact – An NGO previously involved in importing and providing second hand equipment for small manufactures in Uganda
Mennonite Development Agency (MEDA), Tanzania – An NGO micro-credit organisation
SUFFICE- European Development Fund (EDF) – Uganda – A European Union/Government of Uganda programme with a portfolio to small enterprises
East African Development Bank (EADB) – A development bank with a small new leasing programme
Uganda Small Scale Industries Association (USSIA)
United Nations Industrial Development Organisation (UNIDO)
Ministry of Finance – Taxation Department