Chapter 1

Introduction
Right from the beginning of civilization, man has been progressively becoming a part of an economic system. He has conceived different economic activities to suit his convenience. To begin with barter system, succeeded by the exchange for money or money's worth. The traditional trading for money or exchange had its limitations and out of sheer necessity other techniques by which he could satisfy his wants without unduly going against the accepted business norms. Leasing is one such new technique developed by man to meet his growing economic needs. To take advantage of a variety of products available in the market, one workable solution would be to go in for leasing as an effective alternative to storage of ready cash. Right from the beginning, this economic activity has proved to be beneficial both for the producers and the consumers. The prospective consumers could partially finance the purchase by delayed payments made possible through installment or hire-purchase system. A method, originally started on a very small scale, has found wide acceptance in most of the economic activities in the world now. Leasing as an accepted business practice has gained so much importance in all developed nations that a considerable volume of business is done through this modern technique of trade.

The main objective of a business is to maximize the owner's economic welfare. The firm makes investments to maximize stockholder's wealth. After identifying attractive projects, the firm considers various methods of financing them. In addition to debt and equity financing, leasing has emerged as the third important source of intermediate and long-term financing of corporate enterprises during the recent few decades. It is widely used in western countries to finance investments. Prior to 1950, leasing was primarily concerned with real estate, i.e. land and
buildings. But today, almost all types of fixed assets can be leased. In India, leasing is a recent development and equipment leasing was introduced by First Leasing Company of India Limited in 1973 only. Since then, a number of medium to large-sized companies have entered the field of leasing.¹

In recent years, a popular technique of financing the acquisition of fixed assets called ‘leasing’ has changed the magnitude and the colour of business finance. Though the leasing business is of recent origin in India, it is becoming significant in terms of volume of business and also in terms of varieties of transactions. This has evoked interest in the researcher to make a detailed and deep analysis into the leasing business as applicable to Indian conditions. The present thesis is an outcome of this sincere and painstaking analysis of the problem.

Leasing is not something novel, and not the creation of modern businessman. This has existed in some form or the other over the centuries. Perhaps time has made the techniques of this business more scientific and practical. Leasing as a business has extended rapidly into different types of business because of the comparatively greater economic advantages of this system, with the result it is accepted as the most modern way of economic activity running into crores and crores of rupees. No other economic activity or a form of business has gained so much wide acceptance in such a short time as the leasing business. The phenomenal rate of growth is certainly an indication that there is something unique in this form of business.

Although there is no literature available in India on the use of lease financing yet it is interesting to know the lack of popularity of this technique of financing fixed assets. The main reason for the unpopularity of this technique in India may be that Indian businessmen are more inclined to get ownership first rather than to lease the asset. Virtually any asset can be leased e.g. heavy industrial equipment, construction equipment, plant and machinery, aeroplanes, computers, office machines, motor transport vehicles of all sizes and passenger-cars etc.

A lease can be defined, as a, contract between the lessor and the lessee for the hire of a specific asset, selected for a manufacturer or vendor of such assets by the lessee. The lessor retains the ownership of the asset on payment of specified rentals over a period.²

A lease represents a contractual arrangement whereby the lessor grants the lessee the right to use an asset in return for periodic lease rental payments. While leasing of land, building and animals has been known from times immemorial, the leasing of industrial equipment is a relatively recent phenomenon, particularly in Indian scene. Though lease financing represents a marginal source of long term financing in India at present, it is gaining in popularity and is expected to assume greater significance in the years to come.³

Leasing is an arrangement that provides a firm base with the use and control over assets without buying and owning the same. It is a form of renting assets. The lease is a contract between the owner of the asset (lessor) and the user of the asset (lessee), whereby the lessor gives the right to use the asset to the lessee over an agreed period of time for a consideration called the lease rental. The lease contract is regulated by the terms and conditions of the agreement. The lessee pays the lease rent periodically to the lessor as regular fixed payments over a period of time. The rentals may be payable at the beginning or end of a month, quarterly, half-yearly or yearly. The lease rentals can also be agreed both in terms of amount and timing as per the profits and cash flow position of the lessee. At the expiry of the lease period, the asset reverts back to the lessor who is the legal owner of the asset. However, in long-term lease contracts, the lessee is generally given an option to buy or renew the lease.

Concept of Leasing:

In recent years, the word 'lease' has become such to signify a transaction of several years of duration which frequently approximates the depreciable life of the equipment. The ownership of the equipment being financed is vested with the lessor, but the right of use rests with the lessee. The payment for the lease is in the form of an initial down payment or front-end fee. The remaining amount is payable in the form of lease rentals at regular intervals, in advance, in term of monthly/quarterly or annual instalments. As such lessee does not have to put up a stake in the acquisition of the asset. After the fixed period of the lease, the lessee is given an option to renew the lease from time to time, at a nominal or a pepper corn
rental for a secondary period of the lease. The lessee would have recovered his entire investment and profit thereon – i.e. full payment taking place.\textsuperscript{4}

**Legal Aspects of Leasing:**

Leasing capital assets will be feasible only if certain legal problems are favourably resolved. First is the question of ownership. Unlike hire-purchase, both the parties and the court must recognize that the asset is owned by the lessor. This is essential so that the right of depreciation may be reserved for the lessor while the lessee can clearly show the payment as a legitimate expense. To assure that ownership remains with the lessor, no clause covering transfer to the lessee, should be included in the contract, that is, it should not be a conditional sale. The ownership status of the equipment will also affect the lessor's ability to borrow money. As long as the asset remains in the lessor's possession, he may pledge it as a collateral to secure a loan.

The second legal aspect, repossession, is really a continuation of the first, though a different code is involved. For leasing to be an effective method of securing the use of equipment, the lessee must recognize that if the charges are not paid, the equipment will be reclaimed by the lessor with dispatch. Currently such court action takes two months to more than a year to complete. A penalty clause covering the extra cost of repossession would be a partial solution. In the event of insolvency, the lessor is protected as far as repossession is concerned as an asset will not enter into the books of the lessee and the lessor's right would be

\textsuperscript{4} Management Accountant, January 1991, Prof. P. Gopalakrishnan.
unchallenged. This is not true of unpaid lease fees for which he will share with other creditors the assets of the firm.\textsuperscript{5}

\textbf{Legal Framework:}

Leasing is the transaction of special nature that calls for special treatment. There exists no specific law that deals with leasing comprehensively, therefore, General law is applicable to all type of lease transactions including lease financing. The enactment like Indian Contract Act, 1872, Indian Sales of Goods Act, 1930, Transfer of Property Act, 1882, Companies Act, 1956, Import and Export (Control) Act, 1947, Industries (Development and Regulation) Act, 1951, Monopolies and Restrictive Trade Practice Act, 1969, Indian Stamp Act, 1899, The Limitation Act, 1963, Arbitration Act, 1940 etc. contain a variety of provisions, which govern the lease finance and lease agreements between the lessor and the lessee companies in India.

\textbf{1. Indian Contract Act, 1872:}

Lease transactions result in three parties, viz. The manufacturer/supplier, the lessor and the lessee's, coming together to undertake a specific task that is allowed by law. Since lease is the outcome of contract between these parties, it is governed by Indian Contract Act, 1872, therefore, it is obvious that the lease transactions attract

\textsuperscript{5} Indian Management, Barnard E. Smith & Chanani Balkrishna, 1968(7), P. 42-43.
the sections, which spell out relating to the nature of contract, legality of contract, contract of indemnity and guarantee, warranties and conditions, agency, bailment, breach and remedies of the contract etc. The broad principles of general applications to lease are lead down in section 122 to 182 of the Indian Contract Act, 1872.

2. Indian Sales of Goods Act, 1930 : -

A study of the relevant provisions of the Indian Sales of Goods Act, 1930, is essential from the point of view of a lessor, who invests the money in purchasing of an asset or equipment for leasing it out to a lessor. Hence a buyer has certain rights and obligations against the seller or supplier of the goods which should be understood in the right perspective vis-a-vis rights and obligations of a lessor towards the lessor in a lease contract.

3. Transfer of Property Act, 1882 : -

Real estate lease is regulated under the Transfer of Property Act, 1882. Section 5 of this act defines the ‘Transfer of Property’ and also covers transfer of property under lease agreement. Section 6 covers what may be transferred, section 7 competence of a person to transfer, section 10 conditions restricting alienation and section 105 to 117 specifically deal with lease, lessor, lessee and their rights and obligations etc.
4. **Indian Registration Act, 1908 : -**

This act deals with the registration of documents which are required to be registered compulsorily as well as voluntarily. Lease agreements for movable assets are not required to be registered with the Registrar of assurance under the act. However, documents relating to the lease of immovable properties or real estate are required to be registered under the act compulsorily. Section 18(1)(b), which deals with the voluntary registration of an agreement may be relevant for registration of documents of lease agreements of assets other than real estate and property etc.

5. **Indian Easement Act, 1882 : -**

An easement is a right which the owner or occupier of certain land (including things permanently attached to the earth) possesses, as such, for the beneficial enjoyment of that land, to do and continue to do so something, or to prevent and continue to prevent something being done, in or upon or in respect of certain other land owned by him.

The real estate lease contains provisions for transfer to lessee or retention of certain easements with the lessor etc. Lease documents are prepared keeping in view the law of easement as contained in Indian Easement Act, 1882, which applies only to the states of Andhra Pardesh, Tamil Nadu, Maharashtra, Uttar Pardesh and Madhya Pardesh.
6. The Companies Act, 1956:

Any contract made by a company should confirm to object clause of both the lessor and the lessee companies. These companies should have appropriate clauses for rendering leasing services to the client as business objective and for availing of the leasing facilities for acquiring assets on lease from the leasing companies.

Furthermore, a corporate enterprises derives power to contract under its bye-laws or Memorandum of Association in conjunction with Articles of Association. On this basis, it enters into a contract with the leasing company or the lending institution or the bank, which have their standard conditions for financing a lease proposal or for sanctioning a loan. The companies act, 1956, lays down the form of contracts, which can be made on behalf of a company under section 46 thereof.

Section 293 of the act, deals with the restrictions on Powers of Company’s Board. Therefore, the board of directors of a public company cannot ascertain specific financial acts including selling, leasing or otherwise disposing off the whole or a substantial portion of undertaking, remit or give time for repayment of any debt, borrow money etc. except with the consent of such public company in general meeting.
Section 58 A and B of the act deals with the deposits to be invited by issuing an advertisements. Sub section 7(b) applies directly to non-banking financial companies including leasing companies.

Similarly, the provision of section 370 that restricts loans etc. by a public company to companies under the same management is not applicable to the leasing companies because these are the companies established with the object of financing industrial enterprises.

Besides all these specific provisions, the general rules of the company law applies as such to leasing companies as they are applied to other corporate bodies.

7. Import and Export (Control) Act, 1947 : -

The act is applicable only where a person is interested in procuring raw material, machinery, plant or equipments from overseas through imports under the import license obtained from the Government of India. In such cases, the borrower is expected to furnish to the lender’s details of import license obtained under the act.

Section 3, that deals with the powers to prohibit or restrict imports and exports, is of special interest for the lessor companies seeking imported equipments to be leased out in India.
8. Industries (Regulation and Development) Act, 1951 :-

The Government of India has brought under its control the industrial undertakings specified in the first schedule of the act with a view to implement the objectives of its industrial policy under the act. The government regulates the development of scheduled industrial undertakings generally through the registration of existing industrial undertakings, licensing of new industrial undertakings, licensing for producing or manufacturing new articles etc. In relation to a contract of lease, buy or borrow, a corporate body is required to satisfy the compliance of the provisions of the act.


The MRTP Act ensures that the operation of the economic system does not result in the concentration of economic power to the common detriment. The provision of the act are directed towards checking the concentration of economic power, monopolistic trade practices and restrictive trade practices.

The provisions relating to restrictive and unfair practices of the act are explained in section 33(1) of the act. Any clause belonging to restrictive trade practices in the agreement entered by leasing companies will invite the provisions of the MRTP Act. Since leasing companies in India have proceeded mainly on financial leases, the clauses mentioned in the agreement do not come under the restrictive
and unfair practices of the act. Therefore, it is very important to draft the lease agreement in order to avoid the clauses of unfair and restrictive trade practices under the MRTP Act, especially in case of sale and lease back leases and in-house leases. However, when leasing industry diversifies, care should be taken in drafting a lease agreement, in order to avoid the applicability of restrictive and unfair trade practice clauses.

10. **Indian Stamp Act, 1899**: 

The act is a fiscal measure, the principal object of which is to ensure revenue for the state. The act is applicable to all those instruments or documents as mentioned in detail in schedule I attached to it. In general, all documents creating a right or liability reckonable in the terms of money participating whether or not to a movable or immovable property are covered under the stamp act. Agreement to lease moveable property is treated as normal agreement under Indian Stamp Act. The stamp act duty chargeable is governed by state laws. Different rates have been levied by various states governments. Therefore, in order to enter lease agreement, it should be executed on stamp papers in order to eliminate further unnecessary consequences.

11. **The Limitation Act, 1930**: 

Suits relating to contracts are covered under part II of the limitation act, 1930 comprising section 6 to 55 including implied contracts and quasi-contracts. Period of limitation has been fixed at three years in all those cases. Lease being a special
contract attracts all the provisions of the act, which governs the contract and the obligations of parties arising out of the contract.

12. The Securities Contract (Regulation) Rules, 1957: -

Large number of leasing companies are seeking for listing on the recognized stock exchange like other investment companies in order to secure the benefit of tax at concessional rates and getting eligibility for import leasing. The stipulations and rules applicable for listing will be applicable to leasing companies and the Securities Contract (Regulation) Rules, 1957.

13. Income Tax Act, 1961: -

Provisions of Income tax act, 1961, are applicable to all types of leasing companies. Leasing as financing device offers tax benefits to both the lessor and the lessee.

Tax Concessions to Leasing Companies:

Tax concessions available throughout the world to leasing companies are available to an owner. In India, Income Tax Act contains useful provisions on depreciation, investment allowance and other tax incentives, which are of interest to leasing companies as well as the lessees. In view of these concessions, many finance companies have been attracted to undertake the leasing activity. Lessees also get 100% tax deductions for the lease rental paid provided that lease is not a hire-purchase transaction. Any option of purchase of the leased assets renders the transaction as hire-purchase transaction and disentitles the lessee for the tax deduction for lease rental as in that case only interests and not the principal amount
will be tax deductible. Lessor gets benefit in the form of depreciation allowance because they still remain the owners of the asset and depreciation is a tax deductible expense.

Definitions of Leasing:

The main thesis is a descriptive study of leasing in its entirety. Naturally in the process of the inquiry one would come across the use of certain technical terms and phrases which connote specific meanings. For clarity, the researcher has referred to almost all accepted definitions of terms repeatedly used such as Lessor, Lessee, Lease, Lease Agreement, Lease Broker, Asset, Lease Rental, Modes of Termination Lease, Financial Lease, Operating Lease and Leasing, as understood in India. These definitions and meanings are reproduced here for reference so that there would not be any ambiguity.

Parties to the Contract:

There are essentially two parties to a contract of lease financing, viz., the owner and the user, respectively called the lessor and the lessee. Lessors as well as lessees may be individuals, partnerships, joint stock companies, corporations or financial institutions. Sometimes, there may be joint lessors or joint lessees, particularly where the properties or the amount of finance involved is enormous. Besides, there may be a lease-broker, who acts as an intermediary in arranging lease deals. Merchant banking divisions of certain foreign banks in India, subsidiaries of some Indian banks and even some private merchant bankers are acting as lease brokers. They charge certain percentage of fee for their services, ranging between 0.50 to 1 percentage. Besides, a lease contract may involve a
lease financier, who refinances the lessor, either by providing term loans or by subscribing to equity or under a specific refinance scheme.

Asset:

The asset, property or equipment to be leased is the subject-matter of a contract of lease financing. The asset may be an automobile, plant and machinery, equipment, land and building, factory, a running business, aircraft and so on. The asset must, however, be of the lessee's choice suitable for his business needs.

Ownership Separated from User:

The essence of a lease financing contract is that during the lease-tenure, ownership of the asset vests with the lessor and its use is allowed to the lessee. On the expiry of the lease tenure, the asset reverts to the lessor.

Term of Lease:

The term of lease is the period for which the agreement of lease remains in operation. Every lease should have a definite period, otherwise it will be legally inoperative. The lease period may sometimes stretch over the entire economic life of the asset (i.e. finance lease) or a period shorter than the useful life of the asset (i.e. operating lease). The lease may be perpetual, that is, with an option at the end of lease period to renew the lease for a further specific period.
Lease Rentals:

The consideration which the lessee pays to the lessor for the lease transaction is the lease rental. The lease rentals are so structured as to compensate the lessor for the investment made in the asset (in the form of depreciation), the interest on the investment, repairs / insurance if any borne by the lessor and servicing charges over the lease period.

Modes of Termination of Lease:

At the end of the lease period, the lease is terminated and various courses are possible, viz:

(a) The lease is renewed on a perpetual basis or for a definite period, or
(b) The asset reverts to the lessor, or
(c) The asset reverts to the lessor and the lessor sells it to the third party, or
(d) The lessor sells the asset to the lessee.

The parties may mutually agree and choose any of the aforesaid alternatives at the beginning of the lease contract.
Lease is an arrangement by which the lessor gives the right to use an asset for a given period of time to the lessee on rent. It involves two parties, a lessor and a lessee, and an asset which is to be leased. The lessor, who owns the asset, agrees to allow to the lessee to use it for a specified period of time in return for periodic rent payments.6

Conceptually, a lease may be defined as a contractual arrangement / transaction in which a party owning an asset / equipment (lessor) provides the asset for use to another / transfers the right to use the equipment to the user (lessee) over a certain / for an agreed period of time for consideration in the form of / in return for periodic payment (rentals) with or without a further payment (premium). At the end of the period of contract (lease period), the asset / equipment reverts back to the lessor unless there is a provision for the renewal of the contract. Leasing essentially involves the divorce of ownership from the economic use of an asset / equipment. It is a contract in which a specific equipment required by the lessee is purchased by the lessor (financier) from a manufacturer / vendor selected by the lessee. The lessee has possession and use of the asset on payment of the specified rentals over a predetermined period of time. Leasing is, thus, a device of financing / money lending. The position of a lessee is akin to that of a person who owns the same asset with borrowed money. The real function of a lessor is not renting of asset but lending of funds / finance / credit and lease financing is, in effect, a contract of lending money.

The lessor (financier) is the nominal owner of the asset as the possession and economic use of the equipment vests in the lessee. The lessee is free to choose the asset according to his own requirements and the lessor does not take recourse to the equipment as long as the rentals are regularly paid to him.

There is no generally accepted definition of leasing in India. Probably the best known is that adopted by the Equipment Leasing Association.7

"A lease is a contract between a lessor and lessee for the hire of a specific asset selected from a manufacturer or vendor of such assets by the lessee. The lessor retains ownership of the asset. The lessee has position and use of the asset on payment of specified rentals over a period."

With this general definition of a lease, there are two main elements – financial or finance lease and operating lease:

"A financial lease is a contract involving payment over an obligatory period of specified sums sufficient in total to amortize the capital outlay of the lessor and give some profits."

"An operating lease is any other type of lease, that is to say, where the asset is not wholly amortized during the non – cancellable period, if any, of the lease, and where the lessor does not rely for his profit on rentals in the non – cancellable period."

According to Graham Hubbard⁸:-

"A lease is a contract between a lessor, who owns an asset, and a lessee, such that the lessee: -

(a) select the asset from a manufacturer or dealer;
(b) makes specified payments for an obligatory period;
(c) is granted exclusive use of the asset for that period; and
(d) has no right or option to own the asset at any time.

A finance lease⁹ is a lease: -

(a) for the major part of the asset's economic life;
(b) which is non-cancellable or cancellable with a major penalty;
(c) from which the lessor expects to gain his normal profit on the asset without being involved in further activity.

An operating lease¹⁰ is a lease: -

(a) which is cancellable by the lessee at short notice without major penalty; and
(b) under which the lessor expects to re-lease or sell the asset, gaining significant parts of his total profit on the asset from each successive transaction.

Lease has the following characteristics which follow from the above definition:

(a) lessor cannot terminate the lease provided lease meets conditions specified;
(b) the lessor is not responsible for the suitability of the asset to the lessee's business; and

(c) at the end of the obligatory period, the lessee may be able to extend or renew the lease for a further period by making additional specified payments.

In the words of Miller, M.H. and C.W. Uptron:

"Leasing separates ownership and use as two economic activities, and facilitates asset use without ownership."

The Cholamandalam Investment & Finance Co. Ltd., Chennai, one of the leasing companies in India, has defined leasing in its preamble as follows:

"Lease financing is a recent evolution in the Indian scene whereby the asset required by the 'user company' (borrower) is purchased by the 'financing company' and let on lease over a period, on terms and rentals mutually agreed between them. Various courses are possible at the end of the lease tenure."

(a) the lessee may surrender the asset to the lessor;

(b) the lessee may renew the lease on a perpetual basis or for a definite period;

(c) the lessor may take the asset from the lessee and sell it to a third party; and

(d) the lessor may sell it to the lessee.

The choice of the specific alternative is a function of the lease package offered by the lessor at the beginning of the lease tenure."

According to R.M. Srivastava\textsuperscript{12}: 

"Leasing is an arrangement under which a company acquires the right to make use of an asset without holding title to it. A lease, thus, is a written agreement for economic use of assets for a stated period of time. The lease agreement is signed both, by the owner of the assets, called the lessor, and the user, called the lessee. The lessor permits the lessee to use the asset for a specified payment but retains its title. It sets forth the period covered by the lessee, provides for payment of taxes, insurance, maintenance expenses and the like and for renewal of the agreement and the timing and amounts of periodic rental payments made during the lease period.

Harbert B. Mayo has defined leasing as:

"A contract for the use of an asset such as plant or equipment. The firm that owns the asset (the lessee) permits the lessor to use the goods. In return, the lessor enters into a contract (the lease) to make specified payments for the use of the asset. The lease is usually for a specified period and may be renewable."\textsuperscript{13}

John J. Hampton, of George Washington University has defined it as:

"Leasing is an arrangement that provides a firm with the use and control over assets without receiving titles to them. A lease is the written agreement allowing for the use of assets for a specified period of time. The lease is signed by both the owner of the assets, called the lessor and the user, called the lessee."\textsuperscript{14}

\textsuperscript{14} Financial Decision Making, Lease – Buying Decisions, John J. Hampton, 1977, P. 466.
Lawrence J. Gitman has defined leasing in the following words:

"Leasing involves obtaining the use of specific fixed assets, such as land and equipment, without actually receiving title to them. The lessee receives the services of the assets leased to him by the lessor, who owns the assets. In exchange for the use of the assets, the lessee pays the lessor a fixed periodic payment, which is normally made in advance of each lease period. The lease payment is treated as a tax deductible expenditure by the lessee; lease receipts are treated as revenues by the lessor."\(^{15}\)

According to Raymond G. Schultz & Robert E. Schultz, the principle of leasing is basically quite simple:

"The user (tenant or lessee) agrees to pay a rental charge and adhere to other conditions of a lease contract in return for the right to utilize property of the owner (lessor or landlord) in his operations for a specified period."\(^{16}\)

The International Accounting Standards Committee (IASC) has defined a lease as:

"An agreement, whereby the lessor conveys to the lessee in return for rent the right to use an asset for an agreed period of time."\(^{17}\)

(International Accounting Standard No. 17)

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The Times Research Foundation, Pune, India, gives the following definition:

"Leasing means obtaining the services of an asset "on rent" or "on hire.""\textsuperscript{18}

Firms interested in using assets rather than owing them can avail of this facility by paying a series of periodic amounts called "lease payments" to the owner of the asset in return for the services of the asset. The maturity of the contract between the owner and the user is specified in the lease agreement. At the end of the term of the contract the lessee may be given an option to buy the asset, to renew the lease or the lessor may lease the asset to another lessee or sell it."\textsuperscript{19}

The Reserve Bank of India, gives the following definitions for equipment leasing company:

"Equipment leasing company means any company which is a financial institution carrying on as its principal business, the activity of leasing of the financing of such activity."\textsuperscript{20}

Lessor's:

Lessors are those individuals, partnerships, companies, corporations and financial institutions, who lease assets, equipments, to the lessees, under a

\textsuperscript{18} "Lease Financing," The Times Research Foundation, Pune, Rajas Parchure, 1983, P. 1.
\textsuperscript{19} ibid.
\textsuperscript{20} RBI, Department of Financial Companies, Letter 19-11-1984.
contract of lease for a pre-determined lease rental. Many companies with surplus cash resources and a significant tax bill have found that leasing is a useful method of investing their cash profitability and also as a means of deferring payments of their tax bills. Having seen and witnessed the success and outstanding performance of the few lessor’s, many individuals, companies, partnerships, banks, manufacturers have been allured and noticed towards this business. There is no law in India, which restricts dealing and selling of assets on lease. As a result, individuals, partnerships, companies, manufacturers and financial institutions, including the commercial joint stock banks, prefer to play the role of a lessor.

**Choice of a Lessor:**

There may be many factors that should be taken into consideration when choosing a lessor. Out of which some have been discussed below:

1) **Competitive Market Rate**

When the prospective lessees receive the lease quotations, they should make it sure that the parameters upon which the quotations are based are identical and competitive in the market place. Along with it they must ensure that comparisons are made on rentals with or without stamp duty. Utmost care must be exercised in noticing that they are not made merely on the basis of stated interest rates because such interest rates vary in the market depending upon the basis of the lessor’s determination. Examples may be quoted that the lessors may not take into account the interest benefits accruing from the payment of monthly rentals in advance.
Therefore, the lessee should remember that it is lease rentals and residual value and not some stated interest rates which creates impact on a company’s profitability and cash flows.

2) Supplying of Information : -

Prior to entering into a lease arrangement, a potential lessee needs to be aware of possible areas of difficulty during the operation of his facility with his lessor. There will be many informations which will be needed by the lessor from the lessee. For example, ensure that the lessor understands precisely who will be entering for the lease, individual or company. An incorrect name will lead to problems with documentation and probably necessitate the preparations of new papers, which may cause in a delay in settlement and delivery. Give a correct picture of the nature of business and its operation. It will assist the lessor in understanding the lessee’s requirements and making his credit decision. Further, the lessee must give full names, private addresses and dates of birth of the directors/partners to enable the lessor to complete his credit investigations.

A full and accurate description of the equipment being purchased should be obtained from the supplier. This will avoid complications at the time the lease document is prepared thus avoiding delays in settlement.

The lessee should carefully consider the operating schedules and type of work to be performed. A machine that operates two shifts or a vehicle to be used for
rough country work will need to have lower residual than normal. The lessee should be aware of these factors when negotiating a residual with lessor.

The lessor will require the equipment to be comparatively insured. When arranging the policy, it should be in the name of the lessor as owner and applicant as lessee. The lessee should give the name and branch of his bank because this information is needed in the event, the lessee wishes to pay rentals by bank authority.

The supplying of financial statements is the most important aspect of applying for lease credit. In most cases, at least three to four years will be required to enable an accurate assessment of financial trends. Alongwith a full profit and loss statement with a trading and sales analysis may be essential. Further evidence of cash flows surplus enough to meet commitments will strengthen lessee's application. A statement showing sources and applications of funds should also be appended. And an estimated cash forecasts taking into account, the income generated by the equipment to be leased may be very helpful for the lessor with his credit decision.

3) Service:

As the lessee should seek to develop long run relationship with a lessor, the lessor seeks to develop such a relationship with the lessee. A mutual understanding can be established between both the parties by effective communication and with this, the basic requirements of the lessee can be satisfied without perpetual financial appraisal and exposure of the lessees financial position etc.
Similarly the lessor should be in a position to minimize delinquent accounts and losses by developing these relationships. The company of lessor should be adequately staffed with sufficient training on their part so that interaction may take place readily.

4) Stability:

The lessor should be a company of sufficient financial strength with the capacity to absorb fluctuations in the market place particularly in respect of the availability of funds but also to some extent in respect to the mitigation of short term fluctuation in interest rates.

This will enable the lessee to plan and forecast confidently that his leasing requirements will be available at a competitive rate.

5) Professional Advice:

Leasing being a specialized profession, the selection of the lessor should be such that can advise and offer professionally based lease packages to meet the lessee’s fickle requirements timely. The lessor should be in a position to advise the lessee from the mathematical evaluation of lease decision to the matters relevant to taxation, investment allowance etc. The lessee should discuss in details with the lessor on the potential deductibility of rentals and effect on taxation liabilities and should also discuss with his own tax solicitor. The lessor should also be able to structure lease rentals so that they fully reflect all significant matters relating to the transaction from the actual taxation implications, investment allowances, timing of the payments to the supplier to the timing of rentals etc. The lessee should also get
clear assurance about the option to purchase, the leased equipment and whether he
can terminate the lease contract earlier. Therefore, the lessor should not only be
able to advice on these aspects but must have the ability to put that advice into
effect.

Attention should also be paid by the lessee to closely balance capital recovery
in the lease rentals to the residual values. Taking the example of the computer
industry, it can be witnessed that now-a-days with technological transformation,
there has been a continuous decline in the cost of computer hardware, therefore, a
lease contract for a new computer equipment should:

(i) ensure that it qualifies for the investment allowance by being written for
the specified allowed years; and

(ii) ensure that it is written with the lowest possible residual for example 10
per cent at the end of five years lease.

6) Documentation:

There should not arise any documentation problem. The business decisions
must be properly documented and events must be recorded under the lease
agreements. The documentation package should cover thoughtful points both
commercially and legally satisfactory and need not be very lengthy and it need not
cover such ideas of continuing thinking for the purpose of the equipment instead of
leased.
Conclusion:

To conclude this topic one seeks to ensure that decision making by a lessee or potential lessee, properly takes into account not just the initial qualification factors in an evaluation of lease versus purchase but utmost consideration should be given on the qualities for his lease transaction partner i.e. lessor.21

Lessees:

Lessees are those individuals, companies corporations, and institutions which lease assets/equipments, from a leasing company for a predetermined lease rentals, under a contract of lease. The main reason why companies prefer leasing is because of the tax benefits. If they have no tax bill in the immediate future then the alternative of buying an asset and claming the first year investment allowance is not very attractive because the allowance cannot be immediately used. Consequently, leasing provides a way of receiving the immediate benefits and allowances which could be claimed in the first year which the lessor is able to get and the same will be reflected in the lease rentals.

Thus, under these circumstances, leasing seems to be cheaper than the alternatives of borrowing and/or outright purchase, other things remaining the same. It is also true that some companies lease certain assets/equipments, regardless of their tax position or alternative acquisition methods. The main reason for doing so is to avoid the potential risk of adolescence inherent in ownership. The computer may be cited as the best example.

Lease Brokers:

Hardly is there any business where there is no broker and lease is no exception. Since leasing is entering new vistas and territories, and involves certain complications, the lessees are not in a position to select a suitable lessor and find it very difficult to negotiate lower rentals. The whole problem in India is that all three parties, viz., lessor, lessee and lease brokers are quite new to the field. Lease brokers have to establish their reputation to lessees and lessors. Further, the need for the brokers in leasing to create a more competitive market and to introduce new lessees and lessors is acknowledged in the industry, albeit grudgingly by many of those whose profit margins get reduced. However, their expertise generally lies in promoting, developing and evaluating the lease packages for their clients and in providing a total service before and after lease contract, rather than simply obtaining the lowest rate.

With a view to help the lessees, the merchant banking division of the Foreign Banks in India have started lease brokering. There broker’s help the lessee’s in all respects involving the selection of the lessor, negotiation for the rentals and finalization of the lease contracts. For getting such a good lease package, the lease brokers may charge a fee of around 1 to 3 per cent of the lease asset.

The lease broker’s association was formed with the aim of promoting the leasing industry and to regulate the lease broker’s activities.
Lender:

This role is performed by one or more, institutional lenders which lend a major proportion of the cost of the asset to the lessor. The lender will receive interest and principal repayments paid out of the lease payments. While the interest rate will approximate the current rate on long-term mortgages, the precise rate charged depends upon the credit standing of the lessee. The lender receives a registered first mortgage over an asset leased as well as a first charge over the lease payments received from the lessee.

Objective of the study:

The objective of the present study are to examine the growth of selected leasing companies in the private corporate sector in India, their financing patterns and to evaluate their accounting and disclosure practices so as to suggest the changes required to make them in consonance with established accounting norms. Thus, the study aims at seeking answer to the following four sets of research questions:

1. What is the pattern of the growth of leasing industry in India, in terms of number of companies, authorized capital, pattern of activities of leasing companies, structure of the industry and factors responsible for the growth of the industry?

2. What are the major sources of finance and avenues of utilization of funds by the leasing companies?

3. Which are the accounting practices followed by leasing companies in India? Are these practices appropriate from the point of view of various interest groups? What impact the adoption of the ‘Exposure Draft’ on accounting for leases issued by the ‘Institute of Chartered Accountants of India’ will have on the profitability of leasing company?
4. Which accounting practices are appropriate in the opinion of the companies, academics and investors for the leasing companies?

The justification of the present study, therefore, is that it is likely to provide an insight into how the leasing industry may be regulated, so that, the interest of the industry as well as investors may be protected in the best required manner. The significance of the exercise increases in view of the fact that, presently, there are no specific regulations governing the leasing industries working in general and accounting practices in particular.

Moreover, the answer may also help in creating awareness among various interest groups like government, employees, investors, academicians and professionals regarding how the leasing companies are using their funds and reporting about them.

**Research Methodology:**

The present study will be carried out to reveal and analyse some of the important aspects of lease financing prevailing in the Indian scene. The research will be undertaken on the basis of an in-depth analysis of the current literature and primary as well as secondary sources of data will be used. The primary data will be collected with the help of an opinion survey by preparing a questionnaire and secondary data from the published annual reports of the leasing companies.
Period of the study:

The period covered under the study starts from April 1999-2000 to March 2003-04 have been incorporated as the main business of leasing is done during this period.

Scope of the study:

The study is confined to the lessor and leasing companies in the private corporate sector only. The lessee companies will not be included in the study as it will really be not possible to find out lessee companies because they do not disclose in their balance sheet which assets have been obtained by them on lease. Besides, leasing companies also refuse to disclose the names of lessee companies. The leasing operations of financial institutions and banks have also been excluded from the study because their working methods are substantially different from those of private leasing companies. For instance, in case of financial institutions, the source of finance is government rather than capital market and they charge interest according to reducing balance method, whereas, private companies charge it on the basis of straight line method.

Hypothesis of the study:

The hypothesis of the present study is:

- The rate of interest is very high.
- The source of finance is owners equity than the debt-money of the lease financing companies.
- The long-term lease are provided by the lease financing companies.
• The position of the lease financing companies is not satisfactory in the country.

Limitations of the study:

The study is primarily descriptive and exploratory analysis of leasing business in India. The following are some of the limitations of the study:

1. The time period of the study had to be limited to only 5 years spread over 1999-00 to 2003-04. It is not a sufficient time period to make for reaching generalizations. Therefore, the findings of the present study are at the best indicative of the emerging trends rather than conclusive generalizations.

2. Non-availability of data was the second major limitation. Out of 21 leasing companies approached, only 16 companies have provided copies of their annual reports. In many cases, only abridged annual reports were made available by the companies. Such reports provided only sketchy and scanty financial information rendering them useless for our purposes. In many cases, the executives of leasing companies refused to meet the researcher.

3. Most leasing companies in India, are not pure leasing companies, but are mixed. Except for a few, all of them are carrying leasing with other business. Hence, the result arrived at here may not exclusively be due to leasing alone.

4. There exists no specific law that deals with lease comprehensively.

5. The study covers the limited aspects of the lease-financing in Private Corporate Sector in India. There are several other aspects like, comparative cost of lease finance and other long-term financial resources,
role of non-corporate enterprises in lease financing etc., which needs future penetration.

In the case of some of the companies, even their registered address was changed and it was very difficult to trace new address. These factors have been chiefly responsible for reducing the sample to 16 companies.

Due to these limitations, the time taken for the investigative work from proposal stage to the completion stage has been much more than anticipated.

To sum up the present study could have been more comprehensive and meaningful, as we wished to be, if these limitations could be avoided. However, despite these limitations, the present study fills an important gap in the literature and has provided useful insight into the evaluation, growth and accounting practices from the conceptual, empirical and perceptual perspectives.

An overview of research studies

This section attempts to present an overview of studies conducted all over the world in the field of lease financing. Research studies have been conducted in the world both at the theoretical and empirical level. The main focus of these studies have been on the following three aspects:

a. Evaluation of Lease Versus Buy/Borrow Decision;

b. Factor's Responsible for the Growth of Leasing; and

c. Accounting and Disclosure Practices.
a. Evaluation of Lease Versus Buy/Borrow Decision:

The lease versus buy/borrow problem constitutes one of the hard core problems in financial management. Ever since leasing made its appearance, various models have been propounded to analyze the lease versus buy/borrow decisions. It seems that the first systematic attempt in this direction was made by Vancil (1961). After his pioneering work, a number of models for appraisal of lease proposals have appeared in the literature. Some of the major studies in this area are: Bloomfield and Ma (1974), Grinyer (1975), Middleton (1977), Burrows (1977), Herringer and Williamson (1966), Bower (1973), Johnson and Leweleen (1972) and Schall (1974).

These models deal mainly with two issues: (I) Whether leasing is an investment decision or a financing decision and (ii) What discounting rate should be used to analyze lease or buy/borrow proposals. As far as the first issue is concerned, there was agreement among these studies that lease decision was basically a financing decision and not an investment decision. The argument was that the investment decision was made while deciding to acquire the asset leasing the financing decision to be taken at the time of deciding lease or buy/borrow by the lessee. All the models propounded by these researchers suggested the use of ‘Net Present Value’ technique for the purpose of evaluating lease or buy/borrow decision. But there appears to be substantial disagreement as to the discount rate to be used in a lease or buy/borrow analysis for discounting the future inflows and outflows.
Vancil (1961), Bower (1973), Herringer and Williamson (1966), Clark, Jantorni and Gann (1973) have suggested the use of the firm's overall cost of capital (kw) as discount rate. Bloomfield and Ma (1974) favoured using the required rate of return on equity (ke) for this purpose, while Schall (1974) argued in favour of using the risk-adjusted discount rate. Bower (1973) and Burrows (1977) advocated the use of borrowing rate (r) and Middleton (1977), Grinyer (1977), Bierman (1982), Johnson and Lewellen (1972) have attempted to make a case for using the borrowing rate after tax (1-t)r, for the purposes of discounting the future cash flows.

b. Factors Responsible for the Growth of Leasing:


Although there are differences amongst various researchers in terms of the number and kind of factors studied by them for the purposes of their research work, the most important reasons accounting for the growth of leasing in the world appear to be: (I) Tax benefit, (ii) Off balance sheet financing, (iii) Conserves
working capital, (iv) Transfers risk of obsolescence, (v) Preserves debt capacity and (vi) Serves as a hedge against inflation.

This does not imply that these positive aspects of leasing will be of importance in every conceivable situation. The merits and demerits of leasing are mainly determined by the conditions of a lease contract and by the financing alternatives open to a firm's management.

C. Accounting and Disclosure Practices:

Capitalization of leases in the recording of lease transactions in account books of lessees is one of the biggest sources of controversies. It has been argued that a lease transaction creates a financial obligation to pay on the part of the lessee, in consideration of which, the lessee procures a right to use the asset. The financial obligation imposes a liability as future cash outflows can be ascertained with reasonable certainty. The right procured by the lessee creates on asset and this right is of an enduring nature, enduring to the extent of the period of lease. Finance leases, in nature, very similar to lending contracts and hence, the enduring benefit that a lessee acquires, is very similar to the enduring benefit acquired by outright purchase or by borrowing. Therefore, it is argued that in the case of finance lease, the enduring benefit must be reflected as a fixed asset (capitalization of leased assets) in the balance sheet of lessee (Clark, 1977).

The studies in this category have focused on the impact of capitalization of assets obtained on lease by lessees. The studies conducted have attempted to
find the impact of such capitalization on share prices and on the performance indicators of lessee companies.


As far as the impact of capitalization of leases on the performance indicators and resulting influence on financial decisions is concerned, the studies conducted by Nelson (1963), Gritta (1974), Trevor Wilkins and Zimmer (1983), Bazley (1983), Ashton (1984), Weedhams (1985) Herst Figgue (1987) found that capitalization of assets in the books of lessee is likely to have an adverse effect on performance indicators but improves the quality of decisions made by financial analysts.

All the above studies conducted by researchers in various countries shows that the lessees do not prefer to disclose their lease obligations in the financial statements as it affects share prices and financial indicators. However, studies by Trevor Wilkins (1983), Nelson (1963) and Herst (1987) stated that the respondents preferred to disclose their lease obligations through a footnote or an annexure to the financial statement. The Australian studies, like Gardiner (1978), Bazley (1983), Reilly Keith (1984) and Woodhams (1985), however, revealed that the lessee companies in Australia accepted the concept of capitalization for long-term benefit albeit hesitantly.
The overview of the existing studies abroad shows that they have concentrated upon the problems and disclosure practices of lessees only and nowhere these studies have shown interest in lessor companies.

**Indian Studies:**

In India, only a few studies have been conducted and published during the recent years. They have largely concentrated on the analysis of theoretical framework of leasing business in India. These studies explained the problem areas of leasing industry in India without any empirical evidence. These have, however, emphasised the need for studying various aspects of leasing empirically. Parchure and Ashok kumar (1985), Ghosh and Gupta (1985), Joshi (1982), Kothari (1985), Pandey (1986) and Verma (1986) have largely concentrated upon the concept of leasing.

Recently, Karuppiah (1988), tried to examine the following aspects of lease financing in India:

1. Forms of leasing companies working in India;
2. Sources and uses of funds by leasing companies in India;
3. The number of leasing companies listed in the Indian Stock Exchanges;
4. Analysis of profitability of leasing companies.
On the basis of published annual reports of the fifteen leasing companies for a period of one year, he found that there is a marked variation among the companies in respect of capital, reserves & surplus and profitability. He found that the profitability of the leasing companies is lower than the cost of capital. Even then, these companies are distributing high dividend from the very first year of their business operations. The study, though pioneering, has several limitations. In the absence of sufficient data, limited sample covering only one year and limited scope of the study, there is need to undertake a comprehensive and systematic study of lease financing in India.

The present study attempts to analyse the growth of leasing industry in India, funds management of leasing companies, accounting and disclosure practices of companies. While examining the existing disclosure practices adopted by leasing companies in India, an attempt has also been made to study the effect of adopting the guidelines for lessors suggested by the Institute of Chartered Accountants of India. This study is an attempt to suggest the ways and means to improve the efficiency of disclosure practices in the interest of the industry and investors.

**Organization of the study :**

In view of the theme of the thesis, the study has been divided into seven chapters.
- The first chapter gives an introduction of the subject, research methodology and organization of the study ;
The second chapter describes the growth patterns of the leasing industry in India. While highlighting the growth, it explains the factors responsible for growth of the leasing industry and the structure of the leasing industry in India.

The third chapter discusses the types of leasing companies and lease undertakings.

The fourth chapter attempts to analyze the sources and uses of funds of the selected leasing companies in India.

The fifth chapter analyzes the disclosure practices adopted by the leasing industry in India and the impact of adopting the guidelines issued by the Institute of Chartered Accountants of India.

The sixth chapter analyzes the results of the survey regarding the accounting and disclosure practices adopted by the leasing companies.

Finally, the last chapter, i.e., the seventh chapter, gives the summary of findings and conclusions and brings out the policy implications of the study.