CHAPTER VI

SUMMARY AND CONCLUSIONS

Spectacular growth in leasing industry has been a global phenomenon in recent years. Of late, India has also witnessed appreciable growth in its leasing industry. Leasing has graduated from being a manufacturer's selling technique into a booming specialized financial service. The contours of the leasing industry extend from the United States to Europe, Latin America to Africa and Asia. According to a World Bank report (1996), in 1994 over $350 billion worth of new vehicles, machinery and equipment was financed through leasing, accounting for about an eighth of the world's private investment. By 2002, the global leasing business accounted for over $2 trillion. Over the years, leasing has emerged as a mature industry particularly in high-income countries. The United States continues to be a leader both in terms of volume, with $140 billion worth leases written in 1994, and by 2002 it had touched a whopping figure of over $1 trillion in the United States.

The concept of leasing started gaining recognition with the Indian business during the close of 1970s. However, the First Leasing Company of India, launched in 1973, was the first leasing company to operate in India which continued to operate as a sole leasing company in the country until the close of 1970s. In early 1980s, numerous financial institutions and commercial banks had started leasing business. By early 1986, there were 339 equipment-leasing companies in India whose assets leased totalled Rs. 239.55 crore. Their net owned funds were Rs. 81.14 crore and their total debt Rs. 163.9 crore. Besides, there were composite companies engaged in
various activities including leasing as one of such activities and the gross
assets leased by them were Rs. 181.49 crore. That is, the total cumulative
leasing market as on 31 March 1986 stood at Rs. 421.04 crore. A study
published by the Reserve Bank of India in November 2002, which covered
selected 1,024 financial and investment companies in the country, the study
identified 67 'actively operative' leasing companies with a paid up capital of

With a view to have a critical appraisal of evolution, growth, and
contemporary operations as well as standing of leasing industry in India's
capital market, the present study has been undertaken. The entire study has
been divided into six chapters, with four substantive chapters and an
introduction in the beginning and a conclusion in the end. Leasing as a
concept, types of leasing as a financial lease and an operational lease, sub-
heads of a financial lease, pros and cons of leasing, advantages and
limitations for the lessee, advantages and limitations for the lessor, and
current scenario for the leasing industry etc., have been examined in the first
chapter. While scrutinizing various definitional aspects of the concept of
leasing, the present study relies on the definition given a World Bank study in
1997 that defines leasing as "a contractual agreement between two parties,
which allows one party (the lessee) to use an asset owned by the other (the
lessor) in exchange for specified periodic payments."

While identifying lease as of two types- financial lease and an
operational lease, the chapter examines the definition of a financial lease as
envisioned in Statement of Standard Accounting Practice (SAAP) 21, which
defines a financial lease as one in which "the lessee has substantially all the
risks and rewards associated with ownership of an asset other than the legal title." Thus lease financing entails the acquisition of the economic use of an asset through a contractual commitment to make periodic lease payments to a lessor who owns the asset. Having examined three types of a financial lease—direct lease, sale and lease-back and leveraged leasing, the chapter takes into consideration an operating lease and its definitional aspects.

Advantages and limitations for the lessee along with advantages and limitations for the lessor have been appraised in the first chapter. It is revealed from the brief observation of the contemporary scenario of the leasing industry, in the world in general and India in particular, that it is progressively marching ahead in almost all the countries where it has taken roots. A brief overview of related literature on leasing, scope of this study, methodology used in analyzing and interpreting the data and contents, hypothesis etc., have also been incorporated in first chapter.

An analysis of growth of leasing industry in India is facilitated in the second chapter. While laying emphasis on the fact that the leasing industry gained momentum from early 1980s onward, the analysis shows that prior to that it had commenced its operations in India’s capital market at a nascent stage during the later part of the 1970s. In 1973 the Chidambaram group launched the First Leasing Company of India which continued to operate as a sole leasing company in the country until the close of 1970s. In 1979, 20th Century Leasing Private Limited was incorporated as an affiliate of the financial consultants- 20th Century Finance and Consultancy Private Limited, Bombay, which decided that leasing would be a major growth area in industrial financing.
It becomes discernible from the analysis of second chapter that in early 1980s, numerous financial institutions and commercial banks had started leasing operations. In 1983 ICICI, prominent among financial institutions, launched its leasing operations which gave a boost to the leasing industry. Thereafter many new leasing companies emerged in the market. The profit performance of the two leading leasing companies, First Leasing and the 20th Century, and decision of International Finance Corporation (IFC) to open four leasing joint ventures in India evoked favourable market response towards leasing. The entry of public sector banks in the leasing business was one of the most notable features of the development of leasing in India. Of late, almost every nationalized bank in the country indicated intentions to offer leasing facilities and some of the bank-sponsored leasing subsidiaries had become operational. They were also eligible to raise resources by way of loans from their promoting banks, up to a limit sanctioned by the Reserve Bank of India (RBI) which was mostly five times of their net owned funds.

It is observed from the analysis of second chapter that by the end of March 1986, there were 339 equipment-leasing companies in India whose assets leased totalled Rs. 239.55 crore. Their net owned funds were Rs. 81.14 crore and their total debt Rs. 163.9 crore. Besides, there were composite companies engaged in various activities including leasing as one of such activities and the gross assets leased by them were Rs. 181.49 crore. That is, the total cumulative leasing market as on 31 March 1986 stood at Rs. 421.04 crore. The total worth of leased assets in India in 198 stood at Rs 730.8 crore. The assets leased out by the member companies of the Equipment Leasing Association were worth Rs 485.8 crore which constituted
about 67 per cent of the total leased assets. On the other hand, financial institutions and bank-subsidiaries had leased out assets worth Rs 150 crore which amounted to about 21 per cent of the total leased assets. In other words, the leasing companies handled the bulk of the leasing market in India.

A detailed analysis of a study published by the Reserve Bank of India in November 2002, which covered selected 1,024 financial and investment companies in the country in second chapter. This study has identified 67 'actively operative' leasing companies with a paid up capital of Rs 536 crore and their net assets worth Rs 2,223 crore during 2000-2001. The gross fixed assets comprising plant and machinery leased, vehicles and other assets leased, recorded some diminution during 2000-2001. The emerging trends in the growth of leasing industry in recent years in India show that most of the leasing companies have been trying to charter diversified paths in their operations. However, the growth trends for 2000-20001 have not been encouraging for many leading leasing companies. This calls for an urgent need for revamp of the operations of leasing companies so that this trend in negative growth can be arrested at the earliest and a way for healthier growth can be paved.

The third chapter presents a critical analysis of the methods applied by leasing companies in India to raise funds from the market. It becomes evident that leasing companies in India adhere to both conventional as well as non-conventional methods to raise funds from the market. Equity capital, debenture, and bank loans etc., fall within the ambit of conventional sources of finance and public deposits, short-term inter-corporate deposits and some innovative schemes like bank-guaranteed deposits, asset-ownership
instruments, securitized leases and deposit-linked leases etc., come under the purview of the non-conventional sources of finance. Equity capital, to be raised either through private placement or by making a public issue, is essentially the initial source of finance for a company. Relevant legal provisions, particularly those of the Company's Act 1956, pertaining to making of a public issue by a company have been analyzed in the chapter. Almost identical approach follows in respect of debentures and bank loans.

It also takes into account guidelines issued by the Reserve Bank of India (RBI) in April 1988 to the commercial banks in respect of lending to leasing companies. In terms of these guidelines, lending by all commercial banks to leasing companies should not exceed three times of their net-owned funds, and the total amount of external borrowings, including public deposits should not exceed ten times of the net-owned funds. It was further recommended by the RBI that loans to leasing companies should be granted by way of cash credit facility because these loans are essentially against lease rental receivables. Permissible finance against any leasing business, within the limit of three times of net-owned funds, was to be computed on the basis of the lease rental receivables. Periodic filing of regular returns by the borrowing company with the lending bank in the form of monthly, quarterly and half yearly returns in accordance with the RBI guidelines have been briefly appraised in the chapter.

The loan schemes for leasing companies by financial institutions like the Industrial Finance Corporation of India (IFCI) and Industrial Development Bank of India (IDBI) have been dealt with briefly. It is observed that leasing companies are treated as 'industrial concerns' under the amended provisions
of the IFCI. Leasing companies having been in business for complete three years are eligible for long-term loans from IFCI for a period ranging from five to seven years. The Industrial Development Bank of India (IDBI) treats leasing companies on par for the purposes of loan facilities. In recent years the IDBI has extended loans to many leasing companies in India.

While appraising the non-conventional sources of lease financing, the chapter takes into consideration public deposits, short-term inter-corporate loans, bank-guaranteed deposits, asset-ownership instruments, asset-backed securitized leases, deposit-linked leases, and zero-bond coupons etc. Public deposits constitute a potent source of funds for a leasing company. Salaried class consists of the biggest target group for a bulk of public deposits for the companies. The analysis shows that this target group still remains untapped by most of the leasing companies. It is revealed that short-term inter-corporate market does not hold much scope for raising funds by the leasing companies mainly because it is only for a very short duration.

The bank-guaranteed arrangements between the leasing company and the bank is deemed as a congenial scheme for the leasing companies. Another innovative scheme mentioned in third chapter deals with asset-ownership instrument under which a company gives instead of just a charge on an asset a title to the asset as a security to the depositor. Linking deposits with leases is another way of financing consumer leases. The zero-coupon bonds, a cash type of certificates, issued at a discount but payable at par on maturity, are other source of raising finance for leasing companies. The emerging analysis shows that it is almost imperative for the leasing companies in the private sector to tap the non-conventional sources of finance
for steady growth. The methods adopted by the leasing companies to raise finance from the market, as briefly appraised in the third chapter, are not sufficient in themselves. Much depends on the capabilities of a leasing company as to what extent and at what speed it can mobilize those sources and harness them for leasing purposes.

Ways and means of ascertaining creditworthiness of a borrower or a lessee constitutes the focal point of analysis of the fourth chapter. Undoubtedly, assessment or creditworthiness of a borrower or the lessee is very akin to credit evaluation. The concept of credit evaluation in leasing industry entails mechanism for fixing credit policies and procedures, etc. Client, bank references, trade references, credit rating agencies, company financial reports, media reports, stock market opinion etc., are the principal sources of credit information. These are advantageous in evaluating the credit-worthiness of the lessee. Related aspects like the types of information sought from the antecedents of the company, analysis of the financial information, reading of notes to accounts and other information, fixing the credit terms, securing the lease, after-lease monitoring, collection and subsequent follow-up etc., are also significant factors that have been examined in the fourth chapter.

It is revealed that while fixing its credit policies, a company has to consider options like operating in the total risk-free areas or in little riskier areas, its exposure in different regions and the level of its exposure in different industries. A good credit procedure is less time consuming, devoid of redundant information and flexible. Collective scrutiny of credit proposals is regarded as a convenient via media for credit evaluation. It is observed that
among the various sources of credit information, client is the most important source of primary information. Lessee's bank references are useful in ascertaining his or company's general financial health. Trade references acquired from company's customers and suppliers enable to get an idea of prospective client company's payment policies and general financial health.

An inquiry with prospective lessee's business rivals can also be helpful in eliciting information about the client. Besides, credit rating agencies (CRAs) too provide information about a company's financial standing in the market because the CRAs usually compile information about the companies spanning over years. It becomes discernible that yearbooks published by stockexchanges, business publishers and specialized agencies serve as good source of information on companies seeking credit. The information culled from companies' financial reports, press reports, stock market opinions and Registrar of Companies etc., is equally useful in discerning the financial status of prospective client company seeking credit.

It becomes apparent from the appraisal that the information being sought about the prospective client should include antecedents of the company and its promoters, particulars of the projects being handled, details about financial transactions, dividend and tax payments, company's major suppliers and customers, relations with the workforce, qualitative information about management, past experiences of lenders, inter-corporate depositors, fellow lessors, and prospective client company's own past borrowing records etc. Different methods used in analyzing the financial information culled from a company's annual reports for various years have also been examined in this chapter. These methods inter alia include ratio analysis of balance sheet and
profit and loss accounts, lending ratios, liability ratios, asset ratios, debtors/creditors ratios, current ratio, liquid and gross profit ratio, net profit ratio, expenditure to sale ratio, stock turnover rate, etc.

The fourth chapter briefly deals with methods of calculating various ratios viz., stock turnover ratio, creditors ratio, debtors ratio, working capital ratio, let return ratio, return on assets, interest coverage, price/earnings ratio, dividend yield and dividend cover etc. While laying emphasis on financial information analysis through different methods prescribed therein in the chapter, the analysis stresses on going through notes to accounts appended to the balance sheet, accounting policies in respect of depreciation, valuation of inventory, capitalization of expenses, provisions for sunk investments or debts etc. The quantitative information comprising break-up of quantity and value of all major raw materials used, quantitative and value-wise break-up of stocks, turnover and purchases, licensed and installed capacity and actual production is of immense importance. It is further observed that Director's report is a profitable source of information about a company's financial status. Of equal significance is the auditor's report that provides helpful insights into financial dealings of a company.

The noteworthy aspect of fixation of credit terms is to ascertain client's requirements in terms of quantum and period for which credit is required. It is equally important to know the repayment capacity of the client.

While surveying the post-lease scenario, the chapter in its final analysis dwells on the notion of after-lease monitoring. After-lease monitoring assumes significance to prevent further exposure to the same client for which he would frequently approach he was confronted with any difficulties. Regular
interaction with the lessee is likely to ensure regular payment of installments. Besides, it provides occasion to conduct regular inspection of asset’s maintenance and to extend management support to the lessee to help the latter to overcome any difficulty being confronted by him in running or maintenance of the asset.

Accounting policies and practices followed by the leasing companies in India form the pith and substance of analysis of the fifth chapter. The countries where leasing has become a significant player in the capital market, the tendency for accounting has also assumed importance. The question of lease accounting in the developed countries of Europe and the United States is looked upon mainly from the perspective of a lessee. However, in India it is perceived chiefly due to the distortions likely to come in the lessor’s profit and loss account if the leasing revenue is recognized as per the lease agreement. It is observed that in the past leasing was regarded as an off-the-balance-sheet method of financing. The pioneering endeavours in the realm of lease accounting were made by the Committee on Accounting Procedures of the American Institute of Accountants in 1949. A brief description of the growth of accounting institutions that played important role in evolving the accounting standards for leasing in UK and USA has been given in the fourth chapter.

It emerges from the brief appraisal that at the international level the lease accounting is governed by the International Accounting Standards, IAS-17 on Accounting for Leases and FAS-13. The analysis takes into account substance test, full payments test and transfer of title test for lease accounting. Under the ‘substance test’ criterion, a lease transferring substantially all the risks and rewards of ownership is to be regarded as a
finance lease. The full-payments test is a quantitative test designed to see whether the minimum lease payments together with the guaranteed or assured value equal the whole of the asset price in current value terms. Under the 'transfer of title test', if the lease transfers the legal title to the lessee automatically or as an option that is sure to be exercised, the lease is at best regarded as a 'sale' at its very inception.

While appraising methods of accounting for leases, an attempt has been made to analyze allocation of rentals to principal and interest that \textit{inter alia} includes straight-line method, sum of digits method and the actuarial or IRR method. Under the straight-line method, the total interest over the period is the difference between the lease rentals and the lessor's investment. The sum of digits method derives its name from the sum of the outstanding installments in a twelve-month annuity. It is observed that the interest rate in-built in the rentals is the implicit rate of return (IRR). The actuarial method entails the establishment of the IRR and applying the same on the outstanding principal at the time of receiving each payment.

The appraisal of the fourth chapter proceeds to deal with the finance method of lease accounting as per the provisions of the IAS-17, FAS-13 and SSAP-21 etc. Determination of the value to be capitalized or capitalization value, allocation of finance charges and writing-off depreciation are three main aspects involved in lease accounting. Capitalization value, as envisaged in IAS-17, provides that the lease shall be capitalized in the lessee's balance sheet at the lower of the fair market value of the asset or the present value of the minimum lease payments. The allocation of financial charges can be
facilitated by apportioning the difference between the sum total of lease rentals and the asset cost over the period of lease.

While dealing with the Accounting Standard (AS) 19, as envisaged by the Institute of Chartered Accountants of India (ICAI), which has come into force in May 2003, the fourth chapter takes into consideration the key definitional terms used in the AS-19, and also dwells on classification of leases as per AS-19 provisions. A finance lease is defined as a lease that transfers substantially all the risks and rewards incident to the ownership of an asset. An operating lease is defined as a lease other than a finance lease.

While dealing with the date of the lease, it is revealed that any revision in the provisions of the lease agreement renders it a new agreement over its revised terms. In its appraisal of accounting for a finance lease in the financial statements of a lessee, the analysis reveals that the lessee should recognize the lease both as an asset and a liability. This recognition should be at an amount equal to the fair value of the leased asset at the inception of the lease. Disclosure requirements for a lessee are also analyzed.

The analysis further proceeds to examine accounting for an operating lease in the financial statements of a lessee. Disclosure requirements have also been focused on. In its appraisal of accounting for a finance lease in the financial statements of a lessor, the chapter takes into account finance leases by manufacturers or dealers as well. It is observed that a finance lease of an asset given by a manufacturer or dealer lessor gives rise to two types of income- the profit or loss equivalent to the profit or loss accruing from an outright sale of the asset being leased, at normal selling prices, reflecting any
applicable volume or trade discounts, and the finance income over the lease term. It also incorporates disclosure requirements.

An attempt is made to take into consideration accounting for an operating lease in the financial statements of a lessor, its disclosure requirements and sale and leaseback transactions. An interesting aspect of accounting for an operating lease in the financial statements of a lessor is that as per paragraph 45 of AS-19, a manufacturer or dealer lessor does not recognize any selling profit on entering into an operating lease because it is not the equivalent of a sale. Under the disclosure requirements, emphasis is laid on the gross carrying amount, accumulated depreciation and accumulated impairment losses, along with other requirements. A brief assessment of the sale and leaseback transactions is included in the fifth chapter. A sale and leaseback transaction involves the sale of an asset by the vendor and leasing of the same asset back to the vendor. While making an appraisal of relevant provisions of AS-19 in this regard, the chapter has incorporated a tabular illustration showing the requirements of sale and leaseback transactions that result in operating leases. In its final surmise, the chapter expresses optimism that with AS-19 having become operational in respect of leasing in India, leasing industry would thrive smoothly.

**TESTING OF HYPOTHESIS**

The following hypothetical axioms were contemplated to be tested in the present research study:

1. The leasing companies in India have registered rapid strides in the financial markets.

2. The leasing companies have in-built potential to raise funds and channelize them for the development and growth of Indian industry.
3. The lease financing companies in India are following a satisfactory pattern of evaluation of lease financing, including structuring of lease transactions.

4. The accounting practices followed by the major leasing companies in India are different from their counterpart companies in the United States and Europe.

5. Regulations of the Reserve Bank of India (RBI) impact upon the investment pattern of the leasing companies.

The first hypothetical assumption that 'the leasing companies in India have registered rapid strides in the financial markets' is authenticated by the present study. A sample study of 67 selected lease companies by the Reserve Bank of India (RBI) in November 2002, as analyzed in chapter II of the present study reveals that there has been appreciable growth in total net assets of the surveyed leasing companies which stood at Rs 2,223 crore in 2000-2001. The second hypothetical assumption that 'The leasing companies have in-built potential to raise funds and channelize them for the development and growth of Indian industry' is also validated by the fact that these companies have come up well in their leasing operations in recent years. However, this surmise can not be applied in respect of all the leasing companies. There is need for revitalizing the 'sick' leasing companies so that they can utilize their resources in mobilizing funds from the private sector and reduce their dependence on the government financial institutions for raising funds.

The third hypothetical assumption that 'the lease financing companies in India are following a satisfactory pattern of evaluation of lease financing, including structuring of lease transactions', can be said to be partly valid. The reason is that the leading leasing companies which are interested in retaining
their credibility and consumer confidence are prone to follow the norms of the game. However, there are dubious players who promise the moon but back out soon as well because of weak equity base. The fourth hypothetical assumption that 'the accounting practices followed by the major leasing companies in India are different from their counterpart companies in the United States and Europe', seems to have been rendered redundant in view of the coming into being of Accounting Standards-19 since May 2003, as promulgated by the Institute of Chartered Accountants of India (ICAI). The AS-19 is mandatory for all leasing companies. The fifth hypothetical assumption that 'regulations of the Reserve Bank of India (RBI) impact upon the investment pattern of the leasing companies', is attested to by the fact that credit policies are determined by the RBI from time to time and there is no other regulatory authority to oversee the financial transactions of the leasing companies. Hence, RBI’s regulations with regard to credit and investment greatly impact upon the financial transactions of the leasing companies.

SUGGESTIONS

On the basis of the observations and analysis of the present study following suggestions are offered to improve the overall position of the leasing companies in India:

1. A nodal regulatory authority on the pattern of Securities Exchange Board of India (SEBI) should be constituted to protect the funds of the public and investing institutions as well as to oversee the functioning of the leasing companies.

2. The Board of Directors of a leasing company should comprise competent, energetic and knowledgeable persons who can look after
the interests of the company. The practice of appointing retired executives to the Board should be discouraged and the way should be paved for those who can help the company raise funds from the market and elicit good response to public issues.

3. A mechanism for the appraisal of the equipment to be taken on lease should be evolved. Along with the assessment of the credit-worthiness of the lessee, the appraisal of the lease proposal is equally significant. A sort of a lease package prepared on a truly professional manner should provide for lease rentals on accelerating or decelerating basis.

4. A minimum paid up capital of Rs 5 crore should be prescribed for leasing companies as this will enable them to accept proposals of reasonable amount because the maximum amount per borrower should be regulated in relation to the paid-up capital.

5. No leasing company should be permitted to grant more than, 10 to 15 per cent of its paid-up capital and free reserves to a single borrower subject to a ceiling of, say, Rs 4 to 5 million. Implementation of this proposal may help in regulating risk.

6. In order to generate more lease finance, the RBI should announce liberal credit policy for leasing companies. According to conservative estimates, there is a need for lease finance to the tune of Rs 4,500 to 5,000 crore per annum. However, there are about 200 leasing companies having less than Rs 1,000 crore at their disposal. Thus liberal credit policy will boost the leasing industry.

7. The prevalent controversy over the investment allowance in leasing, whether the lessor as owner of the leased asset is entitled to the
benefit of investment allowance since he is not the actual user of the equipment is not conducive to the growth of leasing business. Thus, there is a need to make available investment allowance on a wide range of assets.

8. The sales tax implications for leasing companies should be eased without further delay. As the leasing companies do not enjoy the benefit of 'C' form and hence have to pay the full sales tax on inter-State purchases, thereby being placed at a considerable disadvantage owing to a higher sales tax incidence on the asset.