CHAPTER - 1

INTRODUCTION
1. INTRODUCTION

A lease is a contract whereby the owner of an asset (the lessor) gives to another party (the lessee) the right to use the asset, usually for an agreed period of time in return for the consideration of rent.

The equipment leasing has significantly grown all over the world. Even in India, the rapid growth of equipment leasing could be witnessed. During the last five years, literally six hundred leasing companies have been floated in India; out of which around 100 leasing companies are active. It has also been observed that a large number of industrial organisations both in private and public sectors are considering leasing as one of the alternatives for financing the equipment acquisition.

SCOPE AND OBJECTIVES OF THE STUDY

Presently, leases have come in all the modes, sizes, and varieties. A large number of companies are using or have plans to use leasing as a source of finance either one or the other way. It is interesting to notice the rising share of leased assets to the total investments on assets. For example, the share of leased assets ranged from 5 per cent to 33 per cent in 1988 in the EEC countries and United States. These developments have touched India also. In India, today the use of equipment from satellites and aircrafts to autos is obtained through leasing. Leasing companies have grown from a few lessors in 1980 to more
than 600 leasing companies (public and private limited) by 1988. In India, the equipment leasing boom began in 1985 growing rapidly in the areas of plant and machinery, furniture and fixtures, vehicles, computers and household durables. However, it is mentioned here that though the number of leasing companies increased phenomenally, the size of the business in terms of leased assets did not increase accordingly. Table 1.1 presents an estimate of the assets leased from 1984 through 1989. The growth is noticeable but it is not very pronounced. The leasing industry has mobilised about Rs. 3,000 crore as on 31st March, 1986 (Table 1.2). However, in India, the share of leased assets formed less than one per cent of total investment, in spite of over 600 companies coming into existence by 1988.

**TABLE 1.1**

<table>
<thead>
<tr>
<th>Year</th>
<th>Assets leased during the year (Rs. in crore)</th>
<th>Cumulative assets leased (Rs. in crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984</td>
<td>50</td>
<td>170</td>
</tr>
<tr>
<td>1985</td>
<td>80</td>
<td>250</td>
</tr>
<tr>
<td>1986</td>
<td>180</td>
<td>430</td>
</tr>
<tr>
<td>1987</td>
<td>220</td>
<td>650</td>
</tr>
<tr>
<td>1988</td>
<td>365</td>
<td>1015</td>
</tr>
<tr>
<td>1989</td>
<td>517</td>
<td>1532</td>
</tr>
</tbody>
</table>

Source: Estimates based on the basis of annual reports of leasing companies and other press reports collected by the researcher.

It is observed from the leasing market that leasing companies started quoting different lease rentals for the same transaction. Majority of the companies declared the dividends ranging between 15 and 25 per cent from the first year of operations.
GRAPH 1.1
Assets Leased By Industry

(Rs. in Crores)

- Cum. Assets Leased
- Assets Leased

1995
1996
1997
1998
TABLE 1.2
FONDS MOBILISED BY LEASING INDUSTRY

<table>
<thead>
<tr>
<th>Source of Funds</th>
<th>As on March 1988 (Rs. in cr.)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net owned funds</td>
<td>350</td>
<td>12</td>
</tr>
<tr>
<td>Public deposits and other deposits</td>
<td>2294</td>
<td>74</td>
</tr>
<tr>
<td>Bank borrowings</td>
<td>350</td>
<td>12</td>
</tr>
<tr>
<td>Debentures</td>
<td>76</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>3160</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>


So far there has not been any comprehensive study of the leasing industry in India [1]. This has prompted the researcher to investigate into the structure of the leasing industry in India in general and its financial aspects, in particular.

The specific objectives of the study are as follows:

1. To study the structure of the leasing industry.

2. To analyse the financial structure and performance of the leasing companies, in order to understand the underlying reasons.

3. To review the accounting practices adopted by the leasing companies and lessee companies in India and the managements' reactions to the Guidance Note (GN) on Accounting for Leases issued by the Institute of Chartered Accountants of India (ICAI, 1988) New Delhi.

4. To find out the major problems faced by the Indian leasing companies so that policy recommendations could be made.

[1] See Appendix 1.1 for Literature Review.
Graph 1.2

Funds Mobilised by Leasing Industry

Rs. in Crores
(as on 31-3-1988)

Sources of Funds

- Public Deposits
- Own Funds
- Debt
- Borrowing

890
80
340
2360

- 890
- 80
- 340
- 2360
SAMPLE AND DATA

The study has been confined to public limited companies both in the private and public sectors. For the purpose of study, initially it was thought to study a sample of 142 companies. The sample was selected as on May 1988, Equipment Leasing Association (ELA), India has 77 member companies, consisting of 66 public limited companies and 11 private limited companies. All public limited companies (66) were considered for the study on the basis of judgement sampling as these companies represent the cross section of the leasing industry. Besides, another one private sector leasing company, which was first ever leasing company started in India, named "First Leasing Company of India Ltd, Madras and four public sector organisations which had undertaken leasing as one of their activities viz., Industrial Credit and Investment Corporation of India Ltd. (ICICI), Industrial Reconstruction Bank of India (IRBI) Industrial Finance Corporation of India(IFCI) and SBI Capital Markets Ltd. were also considered for inclusion. Thus 71 companies were chosen on the basis of judgement sampling.

In addition, an equal number (71) of the companies were taken on the basis of random sampling from the population of the 365 companies which had been floated between January 1980 and December 1986. Out of the 426 public limited leasing companies floated during the said period, 61 ELA member companies were replaced from the population. The other seven companies of ELA members were floated before January 1980 as finance and
investment companies or hire-purchase companies and later on, these companies added leasing as one of their activities. The balance of 365 companies were arranged in an alphabetical order and assigned numbers from 1 to 365 to randomly pick up 71 companies. The Fisher's Sample Number Tables were used for this purpose. (Fisher A. Sir Ronald and Yates Frank (1963) Statistical Tables for Biological, Agricultural and Medical Research (6 ed), Oliver and Boyed, London, pp. 134-135.)

In order to collect data for study, we had sent letters addressed to the general managers to all 142 sample companies. Annual accounts for the years 1983-84 through 1987-88, specimen lease agreement and a list of prominent lessees were requested from the companies. This requisition was followed by two reminders in order to ensure good response. The final responses obtained are shown in Table 1.3.

**TABLE 1.3**

**SAMPLE RESPONSES**

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>No. of Companies</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Annual reports received</td>
<td>65</td>
</tr>
<tr>
<td>2.</td>
<td>Letters returned stating that addresses are not found</td>
<td>26</td>
</tr>
<tr>
<td>3.</td>
<td>Responded that not yet started/commenced the business</td>
<td>12</td>
</tr>
<tr>
<td>4.</td>
<td>Responded that not in a position to provide data</td>
<td>4</td>
</tr>
<tr>
<td>5.</td>
<td>No response</td>
<td>35</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>142</strong></td>
</tr>
</tbody>
</table>
The researcher thus had data of 65 companies. Out of these, four companies are not involved in the leasing business, therefore, they were excluded from the study. The received annual reports ranged for one year to five years. But, as shown in Table 1.4, data for all the 5 years were available only for 31 companies.

Apart from the annual report data of these 31 companies, a questionnaire was also used to collect additional information. A comprehensive questionnaire (see Annexure 3) was designed, which was the combination of open and closed (dichotomous, trichotomous

TABLE 1.4

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Annual Reports Position</th>
<th>No. of Companies</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>5 years (1984 through 1988)</td>
<td>31</td>
<td>51</td>
</tr>
<tr>
<td>2.</td>
<td>4 years (1985 through 1988)</td>
<td>5</td>
<td>9</td>
</tr>
<tr>
<td>3.</td>
<td>4 years (1984 through 1987)</td>
<td>5</td>
<td>9</td>
</tr>
<tr>
<td>4.</td>
<td>3 years (1986 through 1988)</td>
<td>4</td>
<td>6</td>
</tr>
<tr>
<td>5.</td>
<td>3 years (1985 through 1987)</td>
<td>5</td>
<td>9</td>
</tr>
<tr>
<td>6.</td>
<td>2 years (1987 through 1988)</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>7.</td>
<td>2 years (1986 through 1987)</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>8.</td>
<td>1 year (1987 or 1988)</td>
<td>7</td>
<td>10</td>
</tr>
</tbody>
</table>

and multiple choice) type. The designed questionnaire covered the important aspects of leasing such as types of leases, marketing of financial leases, number of lease agreements entered, lease rentals, terms and conditions of the lease agreement, accounting practices, problem areas of leasing etc. The questionnaire was mailed to 61 companies. There was not much response to the mailed questionnaire even after constant and
continuous reminders. Therefore, the researcher visited some cities where majority of the leasing companies are located, viz. Ahmedabad, Bangalore, Bombay, Hyderabad and Madras. The researcher had indepth discussions with companies' executives on the important issues and also collected 28 questionnaires duly filled in.

Another set of data collected related to the lessee companies - the users of the leased assets. Leasing companies were requested to provide the names and addresses of their prominent lessees. A list of 179 companies was received. The General Managers (Finance) of these lessee companies were requested to send their annual reports for four years i.e. 1985-86 through 1987-88. Out of these companies, 108 lessee companies (60 per cent) responded. Thus the study is based on 27 questionnaires and 61 annual reports of leasing companies and 108 annual reports of lessee companies.

The study covers the period from 1984 through 1988. The leasing boom in India started in the year 1984, and full operations were effective from 1985 and afterwards, the leasing companies started diversifying to related and unrelated areas, even some of leasing companies disappeared in 1988. The latest figures collected in our study relate to the year ended 31 March 1989 as this was necessary to cover minimum period for some companies.
METHOD OF ANALYSIS

In order to evaluate structure and overall performance of the leasing industry, 31 companies annual reports, which accounted for 40 percent of the total leasing industry in terms of capital employed have been used. For studying the lease accounting practices, 61 leasing companies' annual reports, which accounted for 80 percent of the industry in terms of capital employed, and 108 lessee companies' annual reports, have been used. For the analysis of status and structure of Indian leasing industry, in addition to 28 questionnaire responses and 61 sample companies' annual accounts data, the other secondary source of information, have been used. Broadly the following approach of analysis has been utilised in the study.

1. Financial structure was studied by analysing (a) consolidated funds flow statement for five years, and (b) consolidated as well as individual balance sheets in absolute and percentage terms for five years.

2. Overall performance of the leasing industry was evaluated by analysing (a) consolidated profit and loss for five years, (b) growth measures, (c) profitability ratios, (d) operating efficiency ratios, and (e) earnings ratios. Also an attempt was made to study the structural relationships in terms of size (capital, net worth, net fixed assets and total income), leverage, age and magnitude of lease income.

PLAN OF THE STUDY

The thesis is organised in eight chapters. In this chapter, we introduce the scope and objectives of the study, sample and data collection, and method of analysis and present literature review in Appendix 1.1 to this chapter. Chapter 2, provides an
introduction to the leasing industry in the global perspective. The main emphasis is on the structural, legal and accounting aspects of leasing across the world. Chapter 3 deals with the growth and structure of the leasing (lessor) industry in India, the number and size distribution of the firms, leasing by public sector organisations and industry practices. It also makes an attempt to analyse the structure of the lessee industry and nature of the equipment leased. This chapter also provides the objectives, activities and role of equipment leasing associations. Chapter 4 provides an analysis of the financial structure of the Indian leasing industry. Chapter 5 evaluates the overall profitability and growth of leasing industry. Chapter 6 critically reviews the accounting practices of leasing and lessee companies in India. Chapter 7 highlights the major problems faced by the Indian leasing industry and also identifies the prospects of the leasing industry. The last chapter concludes the findings of the research and provides suggestions for future research.
APPENDIX 1.1
LITERATURE REVIEW

The literature on leasing provides an abundance of information from three perspectives: (1) lease evaluation techniques, (2) advantages (reasons) and disadvantages of leasing and (3) accounting aspects of leasing. In fact, there is not much empirical work conducted in India on leasing so far. We have divided literature review broadly into two parts - first part dealing with the literature on leasing abroad and the latter part covers the literature on leasing in India.

LEASE EVALUATION STUDIES

Most of the literature on leasing originated from the United States. The theoretical literature on lease evaluation can be divided into two: (1) lease vs buy (purchase) analysis and (2) lease vs borrow analysis. There is substantial disagreement in the literature as regards the discount rate to be used in lease evaluation models by the lessee. Anderson and Martin (1977) reported the survey results on the lease evaluation techniques used by the largest firms in the U.S.A. They found that the internal rate of return (IRR) and net present value techniques were the most popular approaches. Besides, the survey results also demonstrated that a significant number of large industrial firms employed lease vs purchase analysis models which could be biased in favour of purchase alternative.

Ang and Peterson (1984) performed a series of empirical tests on a sample of 600 firms covering the period 1976 through 1981. The results indicated that leases and debts were compliments of each other, greater use of debt was associated with greater use of leasing. This finding reappeared consistently for each year, each definition of leveraged ratios and each approach. This complementarity persisted even after refinements were made to the estimation.

Vancil (1961) was amongst the first writers who has suggested the use of basic interest rate (BIR) as the minimum rate that the company would have to pay in order to borrow funds. He considered the choice between buying a piece of equipment and acquiring it under an operating lease essentially as an investment decision and therefore, decision should be taken in line with the lease vs buy. He looked at financial lease as lease vs borrow decision, to be evaluated through the use of basic interest method. Vancil recommended the borrowing opportunity rate (BOR) for lease vs borrow analysis. Ferrare (1966) is one of the first authors who developed a lease vs
borrow model. He stated that investment and financing decisions should be kept separate. However, he argued that a financial lease was a combination of borrowing and investment and recommended cost of borrowing rate as the discount rate to find out the net present value of leasing and purchasing. Bierman (1973) has discussed four theoretical lease evaluation techniques and has recommended the after tax borrowing rate rather than firms' cost of capital as discount rate. Bower (1973) has suggested the discounting of the lease payments at the loan interest rate because of the controversy surrounding the discount rate, he has advocated the use of sensitivity analysis.

Johnson and Lewllen (1972) tried to solve the lease vs buy problem explicitly placing emphasis on the firm goal. They argued that firm should choose an asset and form of acquisition that provide the maximum gains for the shareholders of the enterprise. They capitalised the cash flows at the firm's cost of capital because it was impossible to associate an investment project with specific financing method even though, if they occur simultaneously. They stated that the firm's cost of capital should reflect the long run debt equity proportion chosen by the firm. They considered a financial lease to be an "acquisition of services arrangement" that is equivalent to purchase arrangement.

Clark, Jantorni and Gann (1973) objected to the valuation model suggested by Johnson and Lewllan, because of the inconsistency in the application of two discount rates i.e., the average cost of capital and cost of debt. They also stated that tax savings on depreciation was as certain as the lease payments and these savings should be discounted at the after tax cost of debt. Myers, Dill and Bautista (1976) presented a formula for evaluating finance lease contracts. They used it to solve the firm's lease vs borrow problem and to examine the rationale for leasing. They suggested a weighted average cost of capital for discounting the cash flows. Gordon (1974) asserted that the assets purchase price should be assumed to be financed entirely by raising loan. Gordon first capitalised the cash flow series at the project hurdle rate, assuming perfect capital markets and all equity financing and then the lease payments due to implicit debt financing.

Copeland and Weston (1982) classified leases into pure financial leases and operating leases. The pure financial leases are considered to be perfect substitutes for debt capital because they are not cancellable without bankruptcy and are fully amortized. They recommended after tax cost of debt as the discount rate for finance leases. They stated that operating lease contract is not a pure substitute for debt capital and recommended some higher discount rate than borrowing rate.
Gant (1959) considered leases as rented capital asset. According to him lease financing is not a fresh approach to the acquisition of fixed assets at all, but merely an old friend in disguise. He contended that lease financing is essentially a form of debt financing; perhaps borrowing an asset rather than funds and resulting in obligations which are substantially the same as those incurred in borrowing money. Lease creates a commitment on the part of the company to make a series of payments over a future period of time, which is as much a fixed obligation as the interest and sinking fund requirements. There is evidence of growing awareness among investors and financial analysts of significance of lease commitments and this must inevitably be reflected in accounting charges.

Lev and Orgler (1973) addressed four issues. First, they felt, that tax savings on depreciation should be discounted at the same rate as the tax savings on lease payments because they are at least as predictable. They should be accordingly discounted at the after-tax cost of debt. They preferred comparing the problem of lease vs buy because lease vs borrow option involves the same financial risk.

Sorensen and Johnson (1977) considered finance lease contracts as debt instruments if the capital market is efficient. They recommended the cost of leasing to be the cost of debt or at least the cost of debt plus a risk premium for the uncertainty of salvage value. Their empirical results indicated that the sample contracts substantially appeared as debt. Lessors provided no services beyond financing. Implied costs were quite high, averaging 25 per cent and 19 per cent as before and after tax basis, respectively. The terms and practices differed substantially from one lessor to another.

Most of the analysts report that long term non-cancelable lease is equivalent to debt, and they treat lease payments as a fixed charge or capitalise them or both. Their results indicate that the use of long term non-cancelable lease makes it possible for a company to obtain a greater amount of credit than would be available if debt financing were used.

Weingartner (1987) offered some suggestions for practical lease analysis and the rate for discounting the cash flows. He recommended the firm's cost of capital (weighted average cost of capital) as the most appropriate discount rate. He rejected the borrowing rate on the ground that lenders look to more than the collateral value of an asset for making loans.
STUDIES ON LEASE ADVANTAGES AND INDUSTRY STRUCTURE

The following are some of empirical studies on the advantages of leasing.

Fawthrop and Terry (1978) interviewed 54 senior financial executives of UK large companies to find out the reasons for leasing. Among their main conclusions were:

(a) Lease was often part of a planned financing mix.
(b) The off-balance sheet advantages of leasing were important.
(c) Evaluated alternative leasing agreements against each other.
(d) The transfers of the benefits of 100 per cent first year tax allowances from lessors was relatively unimportant.

Another UK study by Sykes (1976) was based on questionnaire survey of 202 member companies of British Institute of Management looking at "the lease vs buy" decision. Among others, main conclusions were:

(a) Although 83 per cent of companies bought more than two-thirds of their total assets outright and 30 per cent bought all their assets, 45 per cent had used finance leases and 36 per cent had used operating leases.
(b) Leases were used most for office equipment, operating vehicles and large machinery.
(c) Large companies were more likely to use leasing.

According to the respondents, the advantages of leasing are as follows:

(a) Provides source of funds which does not use existing working capital.
(b) Permits 100 per cent financing.
(c) No dilution of equity, no dependence on solvency.
(d) Off-balance sheet financing.

Another study was undertaken by Tomkins, Lowe and Morgan (1979). They investigated the economic performance of lessors based on a sample of 17 of (then) 34 ELA members. Their study was based on mailed questionnaire and detailed interviews with 15 lessors. The findings are:

(a) Leasing market is not homogenous in terms of all lessors operating across all types of leases.
(b) No monopoly exists, a few large lessors do appear to dominate the market. The dominant firms are the subsidiaries of the four major clearing banks, which feature among the top five firms whichever measure of size is used. The results show that top three firms generally accounted for more than 40 per cent of the activity and the largest
five had about 60 per cent. These results do seem to indicate the existence of an oligoplistic market structure.

(c) The segmentation of leasing market confirms that the difference between the groups is substantial both in terms of average lease size and the spread of activities. The middle group encompasses the broad range of lease values but group one tends to concentrate as larger transactions and Group III, the most distinct group, writes over 85 per cent of all leases by number of value for less than 5,000 pounds.

(d) The length of primary period was found to vary directly with the size of the lease typically written. Over time, there has been some tendency for lessors to increase the length of their periods as well as the size of the leases written.

(e) The most important type of equipment lease was manufacturing plant, which accounted for 25 per cent of new leases written in 1976 and data processing equipment features prominently amongst the assets leased, accounted for 18 per cent of new leases in 1976.

(f) In general, financial lessors do not specialize narrowly by commodity class, there is some tendency for firms to concentrate activity in certain areas.

(g) In terms of lessee industry, manufacturing was the most important broad category, accounting for 41 per cent of customers by value of lease written followed by transportation industry.

In their survey study, Anderson (1977) asked executives of 180 American companies to score forty possible reasons for leasing. Inter alia, the important reasons are

(a) Leasing provides 100 per cent deductibility of costs
(b) Leasing provides long term finance without diluting control
(c) Leasing frees working capital for other uses and improve the cash flow
(d) Leasing protects against obsolescence

Ferrara, Thies and Mark (1979) conducted a survey on the extent of leasing decisions. The findings are ranked in Table 1.5.

**TABLE 1.5**

<table>
<thead>
<tr>
<th>Asset Category</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computers and Electronic Equipment</td>
<td>1</td>
</tr>
<tr>
<td>Passenger Vehicles</td>
<td>2</td>
</tr>
<tr>
<td>Duplicating Equipment</td>
<td>3</td>
</tr>
<tr>
<td>Other Vehicles</td>
<td>4</td>
</tr>
<tr>
<td>Buildings</td>
<td>5</td>
</tr>
<tr>
<td>Land</td>
<td>6</td>
</tr>
<tr>
<td>Typing and Office Equipment</td>
<td>7</td>
</tr>
<tr>
<td>Production Equipment</td>
<td>8</td>
</tr>
</tbody>
</table>
Mc Cugan and Caves (1974) conducted a study of non-banking lessors in the United States. They summarised the structural characteristics of American industry in the following way:

The leasing industry’s structure is quite competitive. Self-assessed shares in appropriately defined markets suggest fairly low concentration ratios. The national market is somewhat fractured by size of transaction, region and equipment type. No product differentiation or entry barriers can be found. The industry growth rate is high.

Griesinger (1975) conducted a study to find out the advantages of leasing. Among other findings, the important ones are as follows.

(a) Leasing provides cash flow advantages.
(b) The financing cost of the lease is high but profits on the freed capital may far outweigh the additional expenses.
(c) Leasing does not save taxes, it postpones them.
(d) There are several other advantages which may be of prime importance to the lessee on special circumstances.

Mayers and Nicholas (1988) found that leasing has certain advantages such as avoidance of lump sum expenditure and convenient and flexible source of finance. The study concluded that leasing has had a significant impact on the economy of the UK.

STUDIES OF LEASE ACCOUNTING, DISCLOSURE AND IMPACT

Until recently there was very little empirical work on accounting aspects, which can be divided into three distinct categories

(a) Lease accounting practices and disclosures in the books of lessees.
(b) The effect of reporting and disclosures on the performance indicators used by the financial analysts.
(c) The effect of reporting and disclosures on the stock prices.

Anderson (1962) has made the following remarks about lease accounting practices in the USA context.

Most of the companies that hold property or equipment under lease agreements do not show the resulting property rights and related obligations for lease payments as assets and liability items in their balance sheets. The existence of lease is mentioned at all, ordinarily disclosed in a footnote to the financial statements. The extent of the information given in the footnotes varies greatly from brief
statements of the approximate annual rentals under existing leases to long comments describing the properties leased, the amounts of the annual rental payments, lease periods, renewal options, purchase option etc.

Ashton (1985) studied the effect of lease capitalisation on various indicators of performance thought to be used in financial appraisals. He attempted to answer two questions (1) whether lease capitalisation had statistically significant effect on the main indicators of financial performance and (2) whether the decision by companies in the sample to voluntarily capitalise leases was dictated by the economic consequences. The results suggested that there would be considerable variation in how individual companies were affected. The important finding was that the capitalisation of leases, with the exception of the gearing ratio, had little effect on performance appraisal. Another finding concluded the effect of the capitalisation of leases on inter-firm comparisons of performance was not significant. He suggested the need for more systematic research in the area based both on a much larger sample and number of accounting policy changes.

Altman (1976) concluded that since capitalisation of leases adjustment will produce less favourable ratios than if the leases are not capitalised, the issue was unresolved.

Bowman (1980) investigated the relationship of capital leases to the market risk of lessees. The capitalised value of leases, as reported to SEC under ASR 147 was used to measure the value of leased obligations. A multiple regression model was tested with market risk (beta) on the dependent variable and an accounting beta, debt equity ratio and leases to equity ratio as independent variables. Initial tests found the lease variable was not significantly associated with market risk. However, the leverage and lease variables were highly correlated. Two tests were developed to overcome the multicollinearity problem. Both tests found that when the multicollinearity was controlled, leases made significant contribution to the association tests on market risk. He concluded that leasing made a statistically significant contribution to the market risk.

Elam (1975) conducted a study analysing the effect of lease data on the predictability of financial ratios - for bankruptcy prediction. He concluded that there was no evidence of improved predictability from the use of adjusted ratios but he stated that, somewhat arbitrary procedures used to estimate the effect of lease capitalisation may account for the weak results. He showed that bankrupt firms' ratio of capitalised leases to total assets was significantly greater than the non-bankrupt sample in the third year through five years prior to bankruptcy, but the relative difference in the groups diminished considerably in the
two years prior to failure. However, the study has been criticised by Altman.

Finnesty, Fitzsimmons and Oliver (1980) studied whether the market determined systematic risk of the companies that used leasing extensively was effected by ASR 147, the FASB’s 1977, exposure draft on lease accounting and SFAS 13. The results demonstrated there was no systematic effect as markets assessment of risk bought about by change in financial reporting requirements. Neither the SEC’s ASR 147 nor the FASB’s FAS-13 had any significant effect. They found that the movement of leasing information from footnotes to the financial statements (profit and loss account and balance sheet) had no impact on market’s assessment of systematic risk.

Gritta (1974) examined the effect of long term lease obligations on the debt commitments of 11 firms in the air transport industry, where leasing was known to be an important source of finance. He concluded that long term leasing obligations incurred by these companies significantly increased their existing debt burdens. Similar study by Nelson (1963) examined the effect of lease capitalisation and concluded that analysts might have made incorrect decisions if they had used conventional financial statements as a basis.

Khalik, Thompson and Taylor (1978) indicated that neither the release of information in accordance with ASR No.147 nor lease capitalisation significantly affected the bond prices. Their latter study found that the majority of financial analysts and loan officers in this sample evaluated a company that did not capitalise leases more favourably than an identical company that capitalisation lease.

Myers’ (1962) study revealed that a number of companies, especially in retail stores, lease substantial part of their real estate subsidiaries. He studied the practices of the lessors. Myers reported that many of the leasing companies gave no clue on their balance sheets or in the notes to the balance sheet, to the fact that certain assets were leased. Also they did not give any clue on their income statements that part of gross income was from leased assets. In some cases, companies did not disclose how much of their fixed assets and how much of their income was from leasing, but they did acknowledge the fact of leasing on the financial statements.

Ro (1978) tested whether the disclosure of lease information in accordance with the Accounting Series Release (ASR) No.147 (1973) of the Securities and Exchange Commission (SEC) had an impact on securities’ prices. Ro interpreted his results to indicate that the release of information in accordance with ASR 147 had an
adverse impact on the pricing of securities. In addition, he found that firms disclosing only the present value of minimum lease commitments (a balance sheet effect) were less significantly effected than those firms disclosing both the present value effect and an income effect capitalising leased assets and that high beta firms were affected more than low beta firms.

STUDIES IN INDIA

Despite the importance of leasing in India, no comprehensive research study of the industry has been previously undertaken. Plenty of academic papers have been written on either lease evaluation techniques (lease vs borrow and lease vs buy), or advantages and prospects of the leasing. A few papers have been published on accounting aspects of leasing too. Two or three tentative empirical studies have been made and about half a dozen books have appeared on leasing. However, there is no fundamental study of the leasing industry in India except by Karuppiah (1988). The contribution to the literature was from the leasing practitioners as well as from academicians. Besides, business magazines (including news papers) published a few articles on leasing as cover write up and editorials.

The books on leasing, which were written between 1983 and 1988, confined discussion on concepts and evaluation models. No book was based on empirical work. Those books include Ghosh and Gupta (1985), Joshi (1986), Kothari (1985), Parchure (1983), Parchure and Kumar (1985) and a few others. Some articles are concerned with lease evaluation techniques from the standpoint of lessees and one or two articles are from the standpoint of lessors. These are Brahmani (1990), Ghosh (1987), Kaura and Sharma (1985), Pandey (1986), Pawha (1988a), (1988b), Raghunathan (1987), Ramabadram (1985), Rao and Murthy (1989), Srinivasan (1985) and Viswanath (1985). There were two interesting articles on leasing in the Business India. The first article was titled as "Leasing : The Shake Out to Come" (Behra, 1984). The article was based on the information and views obtained from the leasing pioneers and leaders such as Farouk Irani (Presidnet, First Leasing) Ahuja (Chairman, 20th Century Finance) Kamath (then, the Chief of Leasing, ICICI), Ranina (Chairman, Mazada Leasing and a tax expert), Kampani (a Bombay based consultant), Dayal (Director, Grindlays Bank), and Raju (Director, Nagarjuna Finance Ltd.). The article dealt with the impact of leasing on development of capital market, tax planning, inhouse leasing companies, depression of lease rentals, advantages and growth prospects and profitability of leasing companies.

The second article (Ravindranath and Dass, 1987) was titled as "Leasing Companies : Skating on Thin Ice". This article focussed mainly on the resource crunch and other problem areas of leasing companies. It also stressed the importance of public deposits for the survival of the company. Similarly, there appeared an
article by Srinivas and Shekhar (1987) in the Update. This article covered the profitability and functioning of leasing companies. Most of the other articles concentrated on advantages and prospects of leasing companies.

Ahuja (1983) identified the factors which had inhibited the growth and development of leasing in India. Goswami (1983) wrote on concept and classification of leasing, its advantages and problem areas in India. Hajela (1983) identified the acceptance of leasing in the industrial sector. Joshi (1983) traced the history of leasing and its advantages over the debt form of finance. Nadkarni (1983) stressed the importance of leasing and analysed the impact of leasing companies on the primary and secondary capital market. He linked up the success of leasing companies with fiscal incentives being extended. Parthasarathy (1983) forecasts the potentials of leasing in the near future. Thimmaiah (1983) recognised the importance of skills and expertise in assessing the appraisals of the leases and its consequences. He recommended a rigorous analysis of the credit worthiness of lessees before entering the lease agreement/contract.

Hajela (1984) predicted that leasing had a bright future especially in high technology and high value oriented products. Krishnamurthy (1984) commented on the composition of the boards of leasing companies. He criticised the mad rush of leasing companies for retired chief executives of banks and financial institutions, who did not have any past experience either directly or indirectly in leasing field. He expressed his doubt about the successful performance of leasing companies. Rao (1984) brings out the innovative and flexible schemes both for mobilising the resources and also meet the specific borrowing needs of business and industry. Singh (1984) commented on the public issues of leasing companies and formation of inhouse leasing companies and their tax planning.

Ahuja (1985) commented on the public issues of leasing companies and its competition. He stated that a few leasing companies had diversified into other activities. He wrote about inconsistent depreciation policies of different leasing companies. He suggested the need for self discipline, and a code of conduct of the leasing companies. Dugar (1985) wrote on the future prospects of leasing companies. He stressed the need for professional expertise to explore the leasing business. Gyanchandra (1985) raised important questions on the feasibility and survival of the leasing companies, which did not have trained and experienced executives. Khan (1985) identified the important problem areas of leasing companies. Irani (1985) recognised the tax problem of leasing companies and stated the importance of leasing services to non-priority sectors.
Kumar (1987) reported that the scope of leasing industry was immense in the coming years in the Indian corporate world. Pandey (1987) analysed the structure and prospects of leasing industry in India. He made a comparative analysis of profitability between two groups i.e. independent leasing companies and manufacturing associate leasing companies. His results demonstrated that small size companies are not cost effective and also earn lower return on capital employed. They exhibited marked differences in terms of share capital, size of income, operating efficiency, use of debt and profitability.

There are a few articles on lease accounting. For example, they include articles by Agarwal and Joshi (1983), Ramachandran (1983), Balasubramanian (1985), Vasan (1985) Gupta and Kerkar (1988). It is obvious almost all the Indian literature is of the theory based rather than empirical based. An empirical study was done by Karuppiah (1988). He carried out a study, with the following important objectives. (1) to identify the different sources and uses of funds of leasing companies in India, (2) to find out the types and nature of assets and industries patronised by leasing companies in India, (3) to ascertain the profitability or otherwise of select leasing companies, based on cost benefit analysis and (4) to review the performance of leasing companies. The study was based on 15 companies annual reports for one year only. He provided the concepts, definitions, importance and significance of leasing companies. The analysis demonstrated that (a) there was almost 100 per cent variation between one company and another with respect to share capital; some companies were trading on thin equity and to a large extent depended upon the borrowed capital and a few companies had chosen to trade on thick equity. He also stated that out of 12 companies, three do not have any reserves and six have reserves less than 2 per cent. The major limitation of the study was that the analysis was based on one year annual reports of 15 companies. During that time, the leasing industry was at its infancy stage. Thus there is a need to look at the structure of the leasing industry in a comprehensive manner. The present study, hopefully, shall fill up the gap. We shall focus on the competitive structure, financial pattern and performance, accounting aspects and problems and prospects of the leasing industry in India.