CHAPTER - VII

PROSPECTS OF LEASE FINANCING

7.1 India is on the threshold of a major breakthrough in industrial development, thanks to the farsighted and liberalised economic policy and measures initiated by the government at the centre. Rapid industrialisation is the motto behind every economic measure taken by the government. The equipment leasing industry is fully committed to do its part on the financing side, in the wake of anticipated surge in demand for term funds.

72. Units with investment below Rs. 5 crores were exempted from seeking industrial licence\(^1\). Delicensing of MRTP and FERA companies in respect of 22 out of 27 industries exempted under sec 22A of the MRTP Act was another step taken for accelerating industrial growth\(^2\). In general, procedural delays in the clearance of projects were avoided by the middle of 1980s. As a result of policy initiatives, a large number of companies were newly formed. The number of letters of intent issued during 1985 was 1456 - an increase of 37 percent over those issued in 1984\(^3\). There

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1. Indian Economic Diary, Jan 8-14, 1986, Page 10620
2. Ibid ....
was a substantial increase in the number of new capital issues by non government public limited companies - from 225 issues in 1987-'88, the number went up to 517 in 1991-'92. Similarly consents/proposals granted by Controller of Capital Issues (CCI) to non government public and private limited companies also show a tremendous increase - The consents jumped to Rs. 6124.0 crores by 1990-91 from Rs.2164.6 crores in 1987-'88.

7.3 For the year 1991, the forecast of total capital expenditure of the private corporate sector was Rs. 16,927 crores. Considering the consents given in the year to the extent of Rs. 6124.0 crores, there was a gap of about Rs. 10,000 crores in 1991. According to Equipment Leasing Association (ELA) representative, leasing industry accounts for nearly 10 percent of the incremental capital formation. Based on this estimate, leasing companies foresee an yearly business of Rs. 1,000 crores.

7.4 During the eighth five year plan period (1990-95), a major role has been assigned to the private sector and a

5. Kothari Industrial Directory of India, 1990
total investment of about Rs. 3,00,000 crores is envisaged. According to the Associated Chambers of Commerce & Industry (Assocham), the gap between gross savings and the projected investment in the private corporate sector during the plan period has been estimated at Rs. 43,000 crores. If ten percent of this gap is routed through leasing, there is a scope for an yearly business of about Rs. 900 crores.

7.5 Availability of funds from capital market:

The funding pattern of the eighth five year plan included raising of Rs. 50,000 crores from the capital market. Consents/proposals granted by Controller of Capital Issues (CCI) to non government public and private limited companies during the initial periods of the eighth five year plan shows that the target is not attainable.

Table No: 7.1 Consents/Proposals granted by CCI to non-government Public and Private Limited Companies.(Rs.in crores)

<table>
<thead>
<tr>
<th>Year</th>
<th>Equity Shares &amp; Pref Shares</th>
<th>Debentures</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>1688</td>
<td>5879</td>
<td>7567</td>
</tr>
<tr>
<td>1991</td>
<td>2553</td>
<td>3571</td>
<td>6124</td>
</tr>
</tbody>
</table>

(Amount include premium on shares)

Source: Bombay Stock Exchange Directory.

8. The Indian Economic Diary - Sept 24-30, 1989, Page 12164
Even if the present trend is maintained, on an average, there is going to be a gap of Rs. 3,000 crores a year. The corporate sector in bound to look to other alternative means of financing, especially leasing.

7.6 Raising of funds from the capital market by public issues is becoming unattractive especially for small issues since on an average, more than 10 percent of the funds raised went towards issue expenses. It has been observed that, net public offer did not exceed Rs. 5 crores in 75 percent of cases out of 514 issues studied. The issue expenditure as proportion to net public offer was highest for these issues. Among these, the position of smaller issues was considered even worse. Net public offers ranging between Rs. 1 to 2 crores numbering 90, spent on an average 12.89 percent of net public offer as issue expenditure. In such a situation, companies venturing for a small issue may think of leasing arrangements. According to prime data base report, out of 90 issues made during the month of February 1994, 69 companies resorted to public issue for financing specific projects. Prudent promoters will look into the possibility of the acquisition of assets by leasing.


12. The Economic Times, Bombay, March 19th, 1994, Page 18
Fund raising is not only becoming very costly but also risky. Capital market is becoming highly competitive due to the presence of public limited companies as well as public sector units (PSU). Government has made known its intention to withdraw the budgetary support to public sector undertakings. They had informed the World Bank in December 1992, that it would phase out budgetary support to all public sector units by the end of March 1994 and the budgetary support to most of the profit making public sector undertakings have already been withdrawn. Consequently, the profit making Public Sector Units are entering the capital market for raising fund requirements, thereby posing severe threats to the private sector companies relying solely on capital market. Of late, in a rare move, one of the Public Sector Units, the Metal scrap Trade corporation (MSTC) is planning a right issue at a premium. Prime Data Base reports that public issues are on the poor front. During February 1994, out of 90 issues, 21 companies failed to close their issues on the earliest dates and 11 companies extended the closing dates.

In such situations, promoters with unproven track records will be exploring other financing modes including leasing. During February 1994, out of 90 public issues in

14 Ibid.
15 The Economic Times, Bombay, March 19th, 1994, page 18
the fray, 87 issues were offered by companies making their maiden appearance in the capital market\textsuperscript{16}. In a period of poor response from the investing public, the appearance of further companies in the capital market will be limited. Among other modes of finance for asset procurement, leasing will definitely be an important source.

7.9 **Resource crunch for Financial Institutions:**

Industrialisation process has been accelerated very much resulting in the registration of more and more new companies. Public limited companies registered in 1987-88 was 946 and it increased to 1589 in 1990-91\textsuperscript{17}, a growth of 68 percent over 4 years. But there is no significant increase in the growth rate of total financial assistance disbursed by all the financial institutions put together.

**Table No: 7.2 Loans disbursed by Financial Institutions and the growth rate.**

<table>
<thead>
<tr>
<th>Year</th>
<th>Loans disbursed by financial Institutions (Rs. in crores)</th>
<th>Growth (in percentage)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986-87</td>
<td>5655.6</td>
<td>-</td>
</tr>
<tr>
<td>1987-88</td>
<td>6788.4</td>
<td>20</td>
</tr>
<tr>
<td>1988-89</td>
<td>9163.1</td>
<td>35</td>
</tr>
<tr>
<td>1989-90</td>
<td>10240.2</td>
<td>12</td>
</tr>
<tr>
<td>1990-91</td>
<td>12480.3</td>
<td>22</td>
</tr>
</tbody>
</table>

Source: 43rd Annual Report of IFCI, 1990-91

\textsuperscript{16} Ibid....

\textsuperscript{17} "Company Statistics", Company News and Notes, Various Issues.
In order to tide over the resource crunch of financial institutions, IDBI wanted the business houses to reduce their dependence on financial institutions. Sanction of loans by IDBI, the premier financial institution slowed down during the year 1990-'91 to 22 percent from 31 percent in 1989-90. IDBI raised resources from capital market towards the end of 1991-'92, in order to overcome the resource crunch and appeared in the market with bond issues.

Meanwhile, policy changes taken will continue to reduce the inflow of institutional funds to the corporate sector. The norms fixed for promoter's contribution for purposes of eligibility for getting loans from financial institutions were changed - the minimum contribution of promoters in their projects was hiked to 25 percent. Moreover, with effect from August 16, 1991 the interest rates on financial assistance provided by term lending institutions were made flexible with a floor rate of 15 percent per annum. Institutions are now free to charge higher interest rates on their loans taking into account factors such as credit worthiness of the borrowing units.

18. Indian Economic Diary, Vol XII, Dec 3-9, 1984, No.49
7.11 Of late, promoters with a good track record and sound project, finance cost overruns as well as bridge finance through lease finance route without approaching term lending institutions. New projects floated by entrepreneurs are being partly financed by lease finance. Recent issues such as Peacock industries, Phelix Appliances, Ankit Yarns and Good Earth organic have resorted to lease finance of Rs. 120 lakhs, Rs. 40 lakhs, Rs. 50 lakhs and Rs. 196 lakhs to finance Capital outlay of Rs. 9.6 crores, Rs. 5.6 crores, Rs. 4.50 crores, and Rs. 11.30 crores respectively. Advocates of leasing foresee very good prospects if this tempo continues.

7.12 Long term borrowings of public limited companies from financial institutions as a percentage of net fixed assets shows the reduced inflow of funds from that source. The ratio shows a declining trend over the years.

Table No: 7.3 Long term borrowings as a percentage of net fixed assets.

<table>
<thead>
<tr>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Long term borrowing from financial institutions as percentage of net fixed assets</td>
<td>20.7</td>
<td>20.9</td>
<td>20.7</td>
<td>19.6</td>
<td>19.1</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of India Bulletin, 1987-88

Inability of financial institutions to cope with the demands of companies projects much scope for leasing.

22. The Economic Times, Bombay, July 26th, 1993
7.13 Availability of Term loans from Banks:

The industrial sector was relying heavily on the banking sector for meeting their requirements - At one time, the latter had very little to spare for industries. Owing to high SLR and CRR consequent deposits with Reserve Bank of India, the banks were left with hardly 44 percent of their incremental deposits. This was warranted due to the high inflation which existed at around 17 percent. Out of this, the banks have to meet their obligations towards the priority sector, leaving only a minimal allocation for the industrial and commercial sector.

7.14 There was a hope that the lending obligation to the priority sector will be reduced from 40 percent to 10 percent, as per the recommendations of the Narasimham Committee. In such a situation, banks will be having enough funds for corporate lending. Now the Union Government has rejected the recommendation to cut the banks' priority sector lending23. In 1992-93, 22 public sector banks had fallen short of the stipulated priority sector lending target24. RBI had warned these banks in November 1993, of

23. The Economic Times, March 20th, 1994, Page 1
taking stern action, including the raising of reserve requirements and withdrawal of refinance facilities, if they did not reach their target by March, 1994.\textsuperscript{25} With this end in view, RBI has relaxed the priority sector lending norms of all scheduled commercial banks.

Moreover, banks are facing stiff competition posed by non banking financial companies, in the matter of deposit mobilisation. The rate of growth of bank deposits for the year ending March, 31, 1990, has dropped sharply to 17.6 percent from 23.8 percent in the previous year (1989).\textsuperscript{26} Consequently, the advances by banks rose from Rs. 34,623 crores at the end of March 1989 to Rs. 39,418 crores at the end of March, 1990, showing a rise of 13.8 percent only during the year as compared to the 21.6 percent rise in 1989.\textsuperscript{27} It was reported that in the light of inadequate deposits, certain banks had resorted to rationing of credit also. According to R.L. wadhwa, Chairman cum MD Of Allahabad Bank, the bank may resort to 'rationing of resources' owing to inadequate growth in deposits.\textsuperscript{28} For the year ended 30th June, 1991 also there

\textsuperscript{25} Ibid....
\textsuperscript{26} "Banking and Finance" Business world, Bombay, Aug 1-14, 1990, Page 22.
\textsuperscript{27} Report on Currency & Finance, 1989-90
\textsuperscript{28} The Banker, New Delhi, Dec. 1990, Vol.37, Page 8
has been a sharp decline in bank credit\textsuperscript{29}. The inflow of deposits to banks are likely to be further affected due to the reduction in the interest rate and tax on interest income at source.

\textit{Eventhough the Government has reduced the SLR and CRR rates in the light of reduced inflation rates (around 7 percent in 1993) the recent increase in inflation rate to 10.62 percent in May, 1994 from 5.39 percent in July 1993\textsuperscript{30} may pose problems again to the banking sector. Now, the margin between the interest rate offered and the inflation rate is very narrow (or may even become negative) and in such a situation, the flow of deposits to banks will be severely affected, thereby the ability of banks to advance to the industrial sector will be bleak. Meanwhile, the Government has removed all restrictions on interest rates on debentures and public sector bonds other than tax free bonds of public sector undertakings. The interest rate on these debt instruments will be governed by the market forces. Given a choice between bank deposits and company debentures / PSU bonds with better rates, the investor's preference may be for the latter.

\textsuperscript{30} \textit{The Economic Times}, Bombay, May 2nd, 1994
ones in the present circumstances.

The slow flow of bank credit to industrial sector reflects the reluctance of banks to advance to the corporate sector. The Union Finance Secretary Dr. Montex Singh Ahluwalia has pointed out to RBI that there have been repeated complaints about banks going slow on giving credit to the corporate sector.31

In the wake of insufficiency of funds from Capital market and term lending institutions and inadequacy of bank loans, the prospects of leasing are excellent.

7.17 Prospects of Import leasing:

During the seventh five year plan, the total imports were estimated at Rs. 95,000 crores of which capital goods import will alone be Rs. 20,000 crores or Rs. 4,000 crores per annum as mentioned earlier. Even if a small percentage of such assets are imported under lease basis, the leasing companies foresee very good prospects. Approvals granted for the import of Capital goods during 1989-90 rose to Rs.1,633 crores from Rs. 1,037 crores in the previous year.32 The eighth five year plan (1990-95) aims

at freeing the Indian industry from licensing procedures for import of capital goods and then leasing activities will be popularised further.

7.18 Prospects In The Light Of Policy Changes:

Removal of investment allowance with effect from April 1, 1987 has made leasing very attractive to the corporate sector. Similarly reduction of depreciation for the assessment year 1991-92 (The Taxation Laws Amendment Act 1990) to 75 percent of what would otherwise be allowable have vastly changed the leasing scenario and more companies prefer to go in for lease finance rather than outright purchase of equipment - Based on the increasing scope for lease financing, Equipment Leasing Association of India's asset base is expected to cross Rs. 10,000 crores mark in the next two years from Rs.7,500 crores in 199333.

7.19 Prospects For Sales Aid Leasing:

It is a common practice in developed countries - especially in the US - for vehicle manufacturers to provide credit for the purchase of vehicles through finance companies promoted and managed by them.

Corporations like General Motors and Chrysler have subsidiary finance corporations providing finance for the purchase of cars and trucks. A similar phenomenon is now emerging in India. Vehicle manufacturers have found that it is useful and necessary to offer financial support through finance companies promoted and operated by them.

With a general recession hitting the automobile industry, owing to reduced demand, two wheeler as well as four wheeler manufacturers are tying up with finance/leasing companies to move their products (Example: Kinetic Honda has tied up with 20th Century Finance - Ashok Leyland started Ashok Leyland Finance).

**Increased Scope for Consumer Finance:**

As the production of TV, VCR, VCPs, washing machines records a phenomenal growth, the need for consumer finance becomes more and more imperative. Leasing/finance companies have a major role to play as a catalyst in increasing the sales of these household items. The growth in consumer finance has been fuelled by the burgeoning middle class which has grown from a bare 10 million out of a total population of 350 million in 1947 to 150 million out of over 800 million today.

It is reported that Indian middle class is growing
Experts say that only eight million of the middle class own any one form of consumer durables. Changed attitudes to borrowing, double income families, growing materialism etc. contributed to the boom in hire purchase financing of consumer durables. The share of consumer durables is expected to grow with the introduction of more white goods such as washing machines.

Consumerism defies the policy makers attempts to curtail consumption of luxuries which, the middle class regards as necessities. Given below are ownership levels amongst high income families (monthly income more than Rs. 3,500).

<table>
<thead>
<tr>
<th>Product Category</th>
<th>Ownership Level (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telephone</td>
<td>50%</td>
</tr>
<tr>
<td>Two Wheelers</td>
<td>50%</td>
</tr>
<tr>
<td>Cameras</td>
<td>50%</td>
</tr>
<tr>
<td>Stereo System</td>
<td>50%</td>
</tr>
<tr>
<td>Refrigerator</td>
<td>88%</td>
</tr>
<tr>
<td>Mixer Grinders</td>
<td>85%</td>
</tr>
<tr>
<td>VCP</td>
<td>36%</td>
</tr>
<tr>
<td>Passenger Car</td>
<td>30%</td>
</tr>
<tr>
<td><strong>TVS (Double Ownership of TVS)</strong></td>
<td><strong>106%</strong></td>
</tr>
</tbody>
</table>

Sources: The Economic Times, Bombay, April 30th, 1991
7.22 The business of extending hire purchase facility for consumer durables is attractive for other reasons too. Interest rates are higher on consumer hire purchase than in industrial deals because the former are in no mood to bargain over percentages. In addition, the financing company can also claim the statutory deduction on depreciation by merely including a clause in the agreement. "After all, the consumer is not always a businessman and is unlikely to want this deduction for himself. What pleases him most is that he has technically became the owner of his cherished asset*.

7.23 Most of the finance companies are designing innovative consumer financing schemes to attract this sector - Apple Leasing Company's two schemes - 'Apple car Finance' and 'Apple consumer Durable Finance' have attracted the employees of Rashtriya Chemicals and Fertilizers Ltd., E Merck (1) Ltd., Rallis India Ltd., Unichems Laboratories Ltd., etc - Apple Leasing company's disbursement in this consumer finance area alone was encouraging at Rs. 12 crores during 1989-90 while it was only Rs. 8 crore during the previous year35. Consumer services division of Gujarat Lease Financing Ltd. is

35 Apple Leasing Company Annual Report.
growing at the rate of 50 percent per annum — Disbursement in 1993 of GLFL were to the tune of Rs. 41.04 crores \(^\text{36}\).
estimate of Indias' 'big ticket' leasing requirements over the next ten years as approximately $18.9 billion. His estimate is based on the following.

India's general purpose equipment purchase needs to annualise at US $15 billion over the next decade. Similarly, special purpose specific project equipment needs on a partial estimation, approximate $3.9 billion and relate to the under mentioned details.

a) India's steel mills, especially the Rourkela and Durgapur plants, are projected to require an outlay $1.3 billion on modernisation and upgradation activities.

b) The oil and Natural Gas Commission of India (ONGC), the govt. agency entrusted with India's off shore and on shore oil exploration, anticipated a need to purchase equipment valued at US $1.4 billion for its southern India operations alone.

c) Indian Airlines alone may purchase 32 commercial air craft for approximately $1.2 billion over the next five to ten years - Indian Airlines long term perspective plan indicates that by AD 2001 Indian Airlines expects to move 40 million passengers annually, requiring 45000 seats.
d) India will unquestionably be in the market for super computers.

Thus, based on this factual assessment, the prospects of lease financing in India are bright indeed and it can play a significant role in the industrial development of the country in the years to come.