Lease financing as a mode of corporate finance emerged popular in India during the early eighties. Inspite of the spectacular growth in leasing companies as well as their volume of business, after 1986, the leasing scenario totally underwent drastic changes. Sufficient literature does not exist on the subject and the present state of lease financing in India and its prospects are still unclear. There are confusions about the impact of government regulations on leasing industry. Hence, the present study is an attempt to fill this gap in knowledge.

The primary objective of the study is to examine the present state of leasing industry and to assess the prospects of leasing in India. The evaluation of the financial performance and examination of the impact of Government regulations on leasing industry are the secondary objectives.

The study is an exploratory one and descriptive methods are used for presenting the information. The findings are based on both primary and secondary data. Detailed analysis of companies is made taking a sample of 15 companies at random from a universe of 75 leasing companies.
8.4 Findings:

There has been a phenomenal growth of leasing companies in India after 1982. Bank subsidiaries and financial institutions entered the leasing scenario and big ticket leases began to be undertaken. Currently, a market segmentation has emerged, with private sector leasing companies confining to smaller corporate requirements while the public sector lessors concentrate on big ticket leases.

8.5 The lease returns have declined over the years due to intensified competition and uneconomic rental rates. Hence there has been a fall in the net profit ratios of leasing companies. Consequently many companies switched over to hirepurchase and other activities to augment their earnings. Recently, leasing and hire purchase companies in the private sector are seeking diversification in fund based and non-fund based activities for enhancing the bottomlines. The select areas are bill discounting, merchant banking, portfolio management, consultancy services and so on.

8.6 Leasing is a hedge against obsolescence and in advanced countries sophisticated items prone to become outdated like computers dominate the assets leased. But in India plant and machinery is the major item leased. However, the leasing of assets likely to become obsolete rapidly is emerging popular recently.
8.7 Guidelines on capital issues of leasing companies intended to curb the entry of fly by night operators to the leasing scene, ensured healthiness for the industry. It facilitated the entry of only financially sound companies especially when credit rating became compulsory for finance companies before they entered the capital market.

8.8 Though state Governments are imposing sales tax on lease transactions, treating it as a sale, leasing industry is not permitted to issue 'C' form as the Central Sales Tax Act is not yet amended suitably. Hence leasing companies have to pay around 10 percent or the applicable rate in that state whichever is higher on the assets procured from other states.

8.9 The directive insisting stock exchange listing for undertaking import leasing will only prevent the bank subsidiary leasing companies from doing import leasing.

8.10 Sec. 370 and Sec. 372 of the Companies Act make it difficult for leasing companies, mostly in the private sector, to deploy large amounts as loans and advances during times of low business.

8.11 Reserve Bank of India prohibited commercial banks from extending term loans to leasing companies from 1988.
onwards. This restricted the leasing companies to avail only cash credits and this increased the financial burden as cash credit is costlier than term loans. Frequent interest rate revision by commercial banks pushing the rate to 22.5 percent as on October 1st, 1991 from around 17.5 percent in 1988 made this source unattractive. Only if other sources are not adequate and available, leasing companies utilised bank borrowings. Inspite of the shortage of long term funds, they are not using the full eligibility utilisation of their net owned funds. It is seen that only around 40 percent of the eligibility is utilised by the industry. The percentage of bank loan in total fund declined from 23 in 1987 to 19 in 1990-91.

8.12 The redefinition of deposit liability for ensuring the safety of depositors (including debentures, intercorporate deposits along with public deposits) as per Shah committee report will adversely affect companies with mixed portfolio (debentures, intercorporate deposits and deposits) due to the necessity of maintaining more funds as liquid assets. Companies depending solely on public deposits gain while others stand to lose as funds that could be invested to finance their main activity will have to be deployed in other less rewarding assets inorder to satisfy the liquidity requirements.
8.13 Investments of leasing companies are maintained for complying with the statutory requirements of liquidity norms negating the talk in the industry circles that leasing companies are syphoning funds to group/subsidiary companies by way of investments.

8.14 Substantial reduction in leasing activity during 1987 and 1988 generated surplus funds. Inspite of the applicability of Sec. 370 and Sec 372, such funds were deployed as loans and advances until new leases at remunerative rates came along.

8.15 Well managed leasing companies have efficient debt collection polices. They report nil/low debtor balances and shorter collection period which in turn, have enhanced their profits.

8.16 Though the prudent financial policy is to finance fixed assets and hardcore current assets using long term funds, leasing companies resort to short term funds for financing fixed assets which is very risky, following a highly aggressive financing policy.

8.17 Leasing companies are eligible to borrow 10 times the net worth. But the full eligibility is not utilised inspite of the shortage of long term funds. This is so because the spread between Return on Investment (ROI) and the cost of borrowing is very thin.
8.18 Public deposits are the cheapest source of borrowed funds. But this source is more accessible to companies with reputed group backings. Hence, the finance cost of such companies are maintained at a lower level. The cost of borrowing of young and new companies are high as they have to depend heavily on bank borrowings. There is a visible attempt on the part of many companies to reduce the volume of bank borrowings.

8.19 Finance expense are high for the predominantly hire purchase group as they finance a larger percentage of their activity using borrowed funds compared to the predominantly leasing and mixture group. Moreover, it is found that the pattern of financing also had an impact on the finance expenses. Young and new companies depending more on bank loans incur more financial expenses than older companies depending on public deposits or financial institution loans.

8.20 The operating expenses of large sized companies are nominal being around 6 percent of their income, where as young and new companies incur a higher percentage (around 16 percent) as operating expenses.

8.21 Among the components of operating expenses, it is the other expenses which go up year after year which is to be controlled severely. It is noticed that companies with huge fixed deposits incur large other expenses.
8.22 A variety of accounting practices are adopted by leasing companies in India. The council of ICAI has issued draft guidance note for standardising the accounting procedures of leasing companies. Yet, so far ICAI guidelines are not adhered to by many companies and there exist a lot of mismatch in lease accounting and reported profits.

8.23 Profits of leasing companies do not lend themselves to mutual comparison as there is no uniformity among the companies regarding the charging of depreciation. Majority of the companies are not providing sufficient depreciation to recoup the cost of the asset within a five year period. (Indian leases are mainly for five years).

8.24 Insufficiency of funds from capital market, resource crunch faced by financial institutions and inadequacy of bank loan to corporate sector projects excellent prospects for lease financing.

8.25 Of late, Vehicle manufacturers are competing with each other to offer financial support through finance companies promoted and operated by them to move their products and this adds to the popularity of leasing.

8.26 Leasing/Finance companies are designing innovative consumer financing schemes to attract the burgeoning Indian middle class. These companies have a major role to
play as catalyst in increasing the sale of several household items.

8.27 Conclusions and Suggestions:

Anticipating the increased scope for leasing, there has been a mushrooming growth of leasing/finance companies in the past few years. But it has not been an easy win for all as only a few have been able to make it to the top. Those in the traditional business of leasing, hire purchase and bill discounting are in for trouble not because of the lack of business opportunities. The margins from leasing and hire purchase have become thin and the bill discounting market is choked by Reserve Bank of India banning banks from rediscounting bills originally discounted by finance companies. Yet many companies have managed to face the rough weather. The timely spin off into other fee based activities like merchant banking, forex and corporate advisory services, mutual funds etc. have come to their rescue.

8.28 With the increasing need for capital investments, coupled with inflationary conditions, the demand for long term funds will always outweigh the supply of funds. Thus there is vast scope for leasing companies in the years to come - But all leasing companies will not be a great success. Their success will depend upon how judiciously they pick and choose their business and manage the funds.
8.29 Eyeing the booming financial services sector for increasing the profits will compensate the reduced margin caused by the entry of financial institutions including banks to the leasing arena. Dependence on public deposits rather than bank loans by leasing companies will reduce the funding cost and withstand the reduced return from traditional business line.

8.30 Inspite of the stumbling blocks in the path to prosperity, sufficient scope for leasing companies can be anticipated. The present lack lustre of leasing industry is likely to be short lived. The pragmatic policies of the Government for economic revival through liberalisation offer ample possibilities for reducing the cost of borrowings. Then sufficient spread between Return on Investments (ROI) and cost of funds can be expected. Leasing companies can strive to reduce the operating expenses to the desired level for improving the profits. Besides, diversification to non-fund activities can bring in much returns.

8.31 In short, the future of leasing industry is not as rosy, in the Indian Situation - but it is not bleak either. The important thing is how leasing companies administer their business.
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Books:


