CHAPTER - I

INTRODUCTION

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INTRODUCTION

The world has known leasing since time immemorial. There is evidence that leasing existed as far back as 3000 B.C. The history of leasing can thus be traced from those ancient times to the present. Leasing has been practised in India since the very early times. According to a legend Lord Venkateshwara of Tirupati, the richest deity among the Hindus, had taken Tirumala hills on lease from Lord Varahamurthy. Real estate, and specifically land has been leased out in India for a long time. The leasing of charter-ships, restaurants, shops, cinema halls, housing etc. has been quite common. Even leasing arrangements for running industrial establishments has been seen on a restricted scale. However, leasing generally meant leasing of immovable property, as opposed to equipment leasing. Annexure-I portrays the processes of equipment leasing.

BRIEF OVERVIEW OF LEASING IN INDIA:

Early phase-1970's to early '80's.

Leasing made its appearance in the U.S. more than a century ago. In the 1850's the first railway leasing companies were set up. Later in 1877 the Bell Telephone Company

1. World Leasing Yearbook, 1986
began leasing telephone instruments. The popularity of equipment leasing began in the 1950's. However the Indian financial sector recognised leasing as a source of equipment finance as late as the 1970's. The possible reasons for this may be:

(1) Before independence the British Government hardly paid any attention to the growth of industry or industrial finance.

(2) After 1947 the Government encouraged the growth of industry by setting up several development financial institutions which could provide easy long term finance to industry. Thus the need for different sources of funds was not felt. At the same time the industrial base itself was small.

(3) Indians always had a psychological preference for owning assets rather than leasing them. Consequently they preferred to acquire assets by taking term loans or even through hire-purchase. Thus leasing did not gain popularity.

The credit for setting up the first equipment leasing company in India goes to the First Leasing Company of India Ltd. (FCL), a Madras based company. It commenced business in 1973 and has been the first leasing company to go public and to issue bonus shares.

FCL had the distinction of being the only organized leasing company in the country for a long time, a very rare
feature on the Indian entrepreneurial scene. The second exclusive leasing company that entered the scene in the early eighties was 20th Century Leasing Company Limited, a Bombay based company, promoted by a group of professionals and ex-bankers. After initial entry in equipment leasing in 1980 as a private limited company, it became public in 1982.

Growth Phase Mid-Eighties

In this phase the Indian financial sector identified the real potential and prospects for the leasing industry. The role of leasing was perceived as three-fold:

(a) As a source of equipment finance.
(b) As a tax shield for large profit making companies.
(c) As a sales-aid for manufacturers.

The early eighties saw the pioneer leasing companies doing exceedingly well. Consequently there was a prolific growth of leasing companies, resulting in some 250 to 350 companies entering the capital market in the early eighties. These companies also received a staunch support from the capital market. The volume of assets acquired by the industry was around Rs. 50 crores in 1983 which rose to Rs. 672 crores in 1987.

With the entry of the institutional players the industry received a further fillip and greater expectations were
built up for it. In the institutional sector the Industrial Credit and Investment Corporation of India Limited (ICICI) was the first all India financial institution to offer leasing. ICICI altered its memorandum and articles of association to include leasing and commenced leasing operations during early 1983. The Industrial Reconstruction Bank of India (IRBI), the Calcutta based lending institution also entered the leasing fold around the same time.

A large number of state level financial institutions also showed keen interest in leasing. The Maharashtra State Financial Corporation was the first to commence leasing operations followed by the Gujarat State Financial Corporation which set up a wholly owned subsidiary, Gujarat Leasing Finance Limited for its leasing operations. Among the other State Financial Institutions to join the leasing bandwagon were the Karnataka State Industrial Development Corporation and Pradeshiya Industrial Credit Corporation of Uttar Pradesh.

The first commercial bank to commence leasing activity was the State Bank of India through its subsidiary the SBI Capital Markets which was formed in October 1986. Consequent to its formation, SBI transferred a significant part of its 'non fund' banking activities to the subsidiary and the revenue from the financial services becomes shielded by
the depreciation charge from the lease portfolio.

Canara Bank's subsidiary, Canbank Financial Services Limited is patterned on the model adopted by the State Bank of India. Bank of Baroda started operations via its BOB Fiscal Services Limited, while Punjab National Bank has set up the PNB financial Services Limited. Central Bank of India, Housing Development Finance Corporation and Unit Trust of India have jointly promoted Infrastructure Leasing and Financial services Limited. IFCI and IDBI have also developed term financing schemes for leasing companies. Not to be outdone the foreign banks operating in India have, all along, expressed an interest in leasing. While some plan to offer leasing as a part of their activities, others are either seeking approval to form joint ventures with private groups or plan to establish subsidiaries for this purpose. The Standard Chartered Bank was the first foreign Bank to be granted permission to invest in Cholamandalam Investment and Finance Company, a professionally managed leasing company based at Madras. Subsequently American Express Bank was allowed to participate in Tata Finance, the finance company of the Tatas.

Some manufacturing groups use leasing as a "Sales-aid". A few have agreements with leasing companies to finance the sale of their products. The merchant banking community is
in the picture in a "Lease Broking" role, while many have taken on the role of lessors to shield their revenue with the tax shield from leasing. Lease Broking, as a distinct profit center activity, has caught on with the Merchant Banking Divisions of Commercial Banks, particularly the foreign banks. The role of these banks in the light of their statutory inability to offer leasing is to identify a lessor and a lessee and to arrange a leasing arrangement between the two. The broker's role includes structuring a rental profile acceptable to the lessor and the lessee, executing the legal documentation, and in some cases, extending finance to the lessor. For these services, lease brokers charge a fee computed as a percentage of the value of the transaction. The amendment of the Banking Regulations Act, 1949 and the Reserve Bank of India Guidelines appear in Annexure-II.

Prof. V. Raghunathan of the Indian Institute of Management, Ahmedabad sums up the Indian leasing scenario as under: "In India, equipment leasing as understood in the present day context is no more than 14 years old. After rather a fitful start it has been only after 1983 that leasing has emerged as a serious industry. From less than 15 leasing companies in 1982 there are nearly 500 of them today. The total resources mobilised and the total value of leases written by these companies amount to a little over Rupees
600 crores. An idea about the structure of the industry can be had from the fact that more than 50% of the resources and business written may be accounted for by the first 10 leasing companies alone.¹

The profile of leasing companies through the eighties is somewhat as follows:

**TABLE 1.1**

<table>
<thead>
<tr>
<th>Year</th>
<th>1980</th>
<th>1984</th>
<th>1988</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Exclusively old leasing companies</td>
<td>3-4</td>
<td>5-6</td>
<td>7-8</td>
</tr>
<tr>
<td>2. Finance Companies turned to leasing</td>
<td>3-4</td>
<td>5-10</td>
<td>10-15</td>
</tr>
<tr>
<td>3. Financial Institution that took up leasing</td>
<td>2-4</td>
<td>5-10</td>
<td>10-15</td>
</tr>
<tr>
<td>4. New Leasing Companies</td>
<td>5-10</td>
<td>300-400</td>
<td>200</td>
</tr>
<tr>
<td>5. Manufacturer lessors</td>
<td>-</td>
<td>2-4</td>
<td>5</td>
</tr>
<tr>
<td>6. Leasing subsidiaries of banks</td>
<td>-</td>
<td>1</td>
<td>5</td>
</tr>
</tbody>
</table>

1. Exclusive leasing companies are those which started basically for the purpose of doing leasing business. Some examples of these are First Leasing Company of India Limited, Twentieth Century Leasing etc.

2. There are several finance/hire purchase companies who

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have taken to leasing to widen their portfolios. Some of these being Sundaram Finance Limited, Cholamandalam Finance Company Limited, etc.

3. In the organised institutional sector, the Industrial Credit and Investment Corporation of India Limited has been the first all India financial institution to enter the field of leasing. A large number of State Financial Institutions have also entered the field of leasing mostly by forming their own departments.

4. The growing fortune of some of the early leasing companies led to the mushroom growth of new entrants in the field. In the eighties there was a time when a new leasing company was registered almost every week.

5. Some of the manufacturing corporate giants moved into leasing using it mainly as a marketing tool, e.g. Enfield, Ashok Leyland etc.

6. After amendment to the Banking Act many banks have also entered the leasing field, e.g. Canara Bank, State Bank of India, Vijaya Bank etc.

Thus we see that by the mid-eighties the scope for the industry had broadened in terms of the various types of lessors and the areas of activities had also changed sub-
substantially from pure leasing and hire purchase to various other non-fund based activities like merchant banking, portfolio management, credit syndication, factoring etc. At this time the industry was perceived as very promising one, one that would play a major role as a catalyst to industrial growth.

**Tapering Off Late Eighties**

In subsequent years several problems manifested themselves. These were:

1. The meteoric rise in the number of leasing companies in the market and substantial difference in the cost of funds of private sector leasing companies and the leasing subsidiaries of banks and financial institutions led to cut-throat competition and falling rentals. Rentals that were quoted at Rs 33 per thousand in 1982 dipped to Rs 24 per thousand in 1987.

2. Indiscriminate financial policies adopted by many leasing companies led to an impeding liquidity crisis. Companies that had almost 80% of their total public deposits in one year deposits were using these funds in three to five year leases. In other words short term funds were tied up in long term assets.

3. The accounting policies followed by leasing companies
Revenues were recognised over shorter periods since three to five year leases were written while the assets leased were depreciated over longer periods as the straight line method of depreciation was used. This resulted in an overstatement of profits in the initial years. When dividends are paid out of these profits it actually results in eroding the net worth.

(4) At the same time various amendments in the tax laws made by the Government made leasing less attractive. Empowered by the 46th amendment to the constitution about 14 states decided to clamp sales tax on leases. With Section 115J introduced in 1986 in the income tax act leasing companies had to pay income tax on 30% of their book profits.

The above problems resulted in many ailing leasing companies closing down and survival of the fittest became the norm.

STATEMENT OF THE PROBLEM

Having looked at the birth, meteoric rise and unexpected virtual decline to a plateau of the leasing industry, a proper rationale and objective means of evaluating financial
performance of an industry or a company becomes a very crucial job for all parties concerned be they the macro level policy makers or micro level creditors, depositors, customers, shareholders or even the management. The practice generally used to achieve this end is to study the financial statements and calculate a few ratios to see whether they match a particular norm or not. However, this system leaves a lot of dichotomy. What if a company is good on one ratio and doesn’t match the standard in another? How good is the standard anyway? What is necessary is not a piecemeal dissection but an evaluation of the overall performance of the company. Leasing being in its infant stage in the country one doesn’t even came across set norms for particular ratios. Hence the need for the formation of a comprehensive performance evaluation index that measures the productivity of capital employed in leasing companies.
Since the leasing industry has passed through such Turbulent times in the past one decade a need is felt to examine what kind of future awaits this industry. Hence the study:

"PROSPECTS AND PROBLEMS OF LEASING IN INDIA"

OBJECTIVES OF THE STUDY:

1. To present a comprehensive overview of the problem areas in leasing in India.

2. To identify key factors determining the success of leasing companies and to formulate a comprehensive tool for their performance evaluation.

3. To study the prospects for the leasing industry and to look at recent stock market trends.

4. To illustrate the working of leasing companies by presenting two case studies of leasing companies.