

**GROWTH AND DEVELOPMENT OF LEASING BUSINESS  
IN BANGLADESH: AN EVALUATION**

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**Abstract:** Leasing is a contract between the owner of the equipment (lessor) and the user (lessee) that gives the lessee the right to use specific property, owned by the lessor, for a specific period of time in return for stipulated and generally periodic, cash payments (rents). It is an innovative and alternative way of financing our commercial and industrial undertakings. The business has become more and more popular day by day. Therefore an attempt has been made through this study to explore the lease financing in Bangladesh to trace out the historical backgrounds of leasing in Bangladesh. The study encompasses the operation of lease financing followed by three leasing companies IDLC, ULC, and PLC. The ownership and organizational structure of prominent leasing companies greatly contribute to the success of leasing business in Bangladesh. Leasing business will continue to grow in Bangladesh as a preferred means of acquiring equipment for its convenience and flexibility in financing.

**Keywords:** Lease financing; Lessor; Lessee; Financial lease; Operating lease

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**Introduction**

Bangladesh is an agricultural country gradually shifting towards industrialization. Traditionally, people of this subcontinent were reluctant to business and trade. But as the demand of time, they are inspired and inclined to take risk and establish business enterprises. The entrepreneurs are faced with scarcity of initial capital and if somehow they have started business they face serious shortage of working capital. In such case, they run for long term direct financing from commercial banks, specialized banks and other financial institutions, but receiving long term loans from direct financing institutions in Bangladesh is not an easy task. Leasing business in Bangladesh is providing for the alternative financing introduced by the three prominent leasing companies in Bangladesh; IDLC, ULC and PLC. Recently, some other leasing companies namely, Peoples Leasing Company, Bay Eastern Leasing Company, Industrial Leasing and Financial Services LTD, GSP Finance and a local private commercial bank have emerged in the market.

**Factors Influencing Lease Financing**

All types of assets such as plant and machinery, equipment, transports, land and buildings are subject to lease. Lease varies widely in contractual terms. The variables of lease includes: length of lease term; renewal and purchase options; cancellation provision and penalties; guarantees by

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lessees of residual values; amount and timing of lease payment; Interest rates; Degree of risk assumed by the lessee; and, payment of certain costs such as maintenance, insurance and taxes.

### **Lease Classification Criteria**

From the standpoint of the lessor, all leases may be classified for accounting purposes as follows:

**a) Capital or financial lease:** To be a capital lease, it must satisfy one or more of the following four criteria: (1) The lease transfers ownership of the property to the lessee, (2) The lease contains a bargain purchase option, (3) The lease term is equal to 75% or more of the estimated economic life of the leased property, (4) The present value of the minimum lease payment (excluding executory costs) equals or exceeds 90% of the fair value of the leased property. (Stamford, Conn. FASB, 1980). Office building, Multipurpose industrial building and even complete shopping centers are frequently financed with this method. Most lease backs are on a net-net basis, (Hamilton, John J, 1992) which means that the lessee pay all maintenance expense, property taxes, insurance and lease payment (Khanam K, 1995).

**b) Operating lease:** Operating leases result in the recognition of only rent expense. Under the operating lease each rental receipt by the lessor is recorded as rental revenue. Leases that do not meet any of the four criteria are classified and accounted as operating Lease. Short-term cancelable lease agreements are called operating lease. Computers, copiers, telephone services, etc. are often obtained by operating leases. An operating lease is usually characterized by the following features: (1) The lease is cancelable by the lessee prior to its expiration; (2) The lessor provides service, maintenance and insurance; and (3) The sum of all lease payments by the lessee does not necessary fully provide for the recovery of the asset cost (Jones, 1992).

**c) Sale-leaseback:** The term sale-leaseback describes a transaction in which the owner of the property (seller-lessee) sells the property to another which is simultaneously leases it back from the new owner. The use of the property is generally continued without interruption. The advantages of a sale lease back from the seller's viewpoint usually involve two primary considerations:

- (1) Financing – If the purchase of equipment has already been financed, a sale-lease back can allow the seller to refinance at lower rates, assuming rates have dropped. In addition, a sale-leaseback can provide another source of working capital, particularly when liquidity is tight.
- (2) Taxes- At the time a company purchases equipment, it may not realize that it was going to be a minimum tax and that ownership might increase its minimum tax liability. By selling the property, the seller-lessee may deduct the entire lease payment, which is not subject to minimum tax considerations.

### **Case Studies**

**Three Prominent Leasing Companies in Bangladesh:** The lease as a means of transferring right to use property has undergone a speedy growth since World War II. In U.S.A. and in Europe, lease financing has contributed largely to business development. Recently in Bangladesh, leasing both in real estate and in equipment, has started and many financing companies are extending the facilities to the prospective users of lease. It is helping people who are interested in owning real estate and equipment for business purpose. The FASB recognized this growth and commented as follows: -

“Leasing as a means of acquiring the right to use property has proliferated markedly throughout the post-war period. But it was the decade of the 1960s that saw the greatest expansion, not only in the volume of leasing transactions, but also seen the variety of application and degree of sophistication of the techniques employed. During the period, according to some estimates, leasing grew at an average annual rate of between 15 percent and 20 percent. It was estimated that over Tk. 11 billion

in new equipment was leased in 1974 and that by the end of 1975 equipment on lease would be Tk. 100 billion<sup>7</sup>. Growth of leasing in Bangladesh can be described by studying the profile of three prominent leasing companies such as The Industrial Development Leasing Company (IDLC) Ltd., The United Leasing Company (ULC) Ltd. and Phoenix Leasing Company (PLC) Ltd.

**a). Industrial Development Leasing Company (IDLC):** Industrial Development Leasing Company (IDLC) of Bangladesh Limited is the first and the largest leasing company of the country. IDLC has been established with the multinational collaboration of Development Finance Institutions, Commercial banks, Insurance and leasing companies. The leading leasing companies of the country, IDLC was incorporated on the first day of October in 1990 opened its one and only branch at Chittagong. After 10 years of its commencement, IDLC has captured almost 60% of the total market share of lease finance in the country. IDLC was listed in Dhaka Stock Exchange (DSE) on the 20<sup>th</sup> of March 1993 and on the 7<sup>th</sup> of February 1994, it was licensed under the Bangladesh Bank. IDLC, the pioneer leasing company in the country was set up in the private sector to serve as an additional and alternative source of capital asset financing in different enterprises. The lease finance to individuals is rare and corporate financed through operating lease is the general nature of business. Generally, IDLC does not encourage new entrepreneurs or new line of business. Thus, BMRE (Balancing, Modernizing, Replacing and Expanding) is the main objective if finance or leasing, when equipment is concerned for vehicle both new and reconditioned cars is taken into consideration. IDLC has a well-diversified portfolio of leases. Its clientele is primarily corporate bodies. The ratio of corporate to individual clients is 95:5. It mainly deals in equipment leases although vehicles have a significant share. IDLC's business performance is very encouraging. It has experienced increasing growth of lease contracts from 1993 to 1997. During this period the compound growth rate of lease contract was 29.31%. Financial results of the company have been very strong. Operational revenue has increased from Tk. 275.54 million in 1993 to Tk.768.55million in 1997. Operating income has also increased during the same period. In1993 operation income was 57.26 million and in 1997 operation income has been Tk.112.67. The company is managed by its Board of Directors consisting of nominees of the shareholders as per shareholders agreement and in line with the statement General and Optional policies of the company. The shareholders nominate Board of Directors consisting of two directors from IPDC, two from CBL, one from SBC, three from KDLC including KLB, one IFC and the Managing director as an ex-officio member. The Board appoints the chairman form among the Directors nominated by IPDC as per stipulation and the shareholders Agreement (Annual report, 1992-1997).

**b). United Leasing Company (ULC) Ltd.:** Subscription agreement was signed among the sponsors to form the United Leasing Company Ltd. on the 9<sup>th</sup> March 1989. The company was incorporated on the 27<sup>th</sup> April, 1989. Investment agreement has signed by the company with ADB in Manila on 27<sup>th</sup> July 1989. The company signed the first lease agreement with the lessee on 12<sup>th</sup> September 1989. The ULC signed a loan agreement with CDC in London on 27<sup>th</sup> March 1992. The company issued 75,000 shares on 28<sup>th</sup> March 1994. Its operation expanded further and the company opened its first branch in Chittagong on 16<sup>th</sup> June 1994. It traded its shares on Dhaka Stock Exchange (DSE) for the first time in 23<sup>rd</sup> June 1994. It was duly licensed under Financial Institutions Act, 1993 on the 7<sup>th</sup> February 1995. The company declared first dividend on 20<sup>th</sup> April 1995. The company's authorized capital is Tk. 120 million and issued, subscribed, and paid up capital isTk.70 million (Annual report, 1992-1997). ULC financed its portfolio largely through medium and short-term loans from local banks and long-term loans form the World Bank and KFW of Germany. The cost of local fund both medium and short-term was higher compared to the previous year. So, the company sought for loan form outside the country. In order to increase its share of business, the company plans to improve further the quality of service by importing additional training to staff and by use of modern technology. It is also contemplated to add new service and expand service points to meet the needs of new customer types. ULC's business performance is very encouraging. It has experienced increasing growth of lease contract from 1993 to 1997. During this period the

compound growth rate of lease contract was 39.78%. Financial results of the company have been very strong. Operational revenue has increased from Tk.97.57million in 1992 to Tk. 523.40 million in 1997. Operating income has also increased during the same period. In 1992 operating income was Tk.15.63 million and in 1997 it has become Tk.68.86 million.(Annual report, 1992-1997).

**c). Phoenix Leasing Company (PLC) Ltd.:** The phoenix leasing company (PLC) Ltd. was incorporated on 19th April 1995. It commenced business on the same date. It was duly licensed under Bangladesh Bank on 9th May 1995. It signed the first lease agreement on the 21st September 1995. Its operation expanded further and the company opened its branch in Chittagong on 25th September 1996. The authorized capital of the company is Tk.500 million and issued; subscribed and paid-up capital is Tk.50 million. Phoenix Leasing Company (PLC) Ltd. is a promising leasing company. Its business performance is very much encouraging. It has experienced super growth rate of lease contract gross amount and of execution amount (Annual report, 1992-1997).

Table 1. Growth of lease finance and total domestic credit during the period.

Lease finance			Total domestic credit		
Year	Amount (Tk. in million)	Growth rate (%)	Year	Amount (Tk. in million)	Growth Rate (%)
1993	494.65	32.13	1992-1993	292738	7.59
1994	714.63	44.47	1993-1994	306952	4.86
1995	1192.97	66.93	1994-1995	360853	17.56
1996	2194.15	83.92	1995-1996	434524	20.42
1997	2801.18	27.67	1996-1997	493966	13.68

Sources: Asian Leasing Association, 1998, p. 49; Bangladesh Bank Annual Report 1996-1997, pp. 106, 123; Bank Parikrama, March 1999, p. 163.

## **Strength and Weakness of Leasing**

### **Strength:**

**a). Shifting the risk of technological obsolescence:** In the case of ownership, the firm bears the risk of the asset becoming obsolete. This dimension of potential risk is too important to be ignored and particularly in the present equipment more expensive to operate and totally inadequate to meet the company's competitive needs and thus inflict heavy losses to the firm. Leasing provides a cushion against all such hazards by shifting the risk of obsolescence of equipment to the lessor.

**b). Easy source of finance:** A lessee avoids many of the restrictive covenants that are normally included in Long-term loan agreements while borrowing from financial institutions or commercial banks. Besides, the leasing does not warrant any mortgage or hypothecation of the asset since it belongs to the lessor. Above all, in the case of leasing, the asset is made available to the lessee for immediate use without loss of time in applying for loan, waiting for its approval, buying asset subsequently, etc. and lease rental payments may also be matched with the cash flows availability of the lessee.

**c). Enhances liquidity:** The use of sale and lease back arrangement may permit the lessee firm to salvage its weak liquidity position by converting its existing fixed asset into cash, the funds so released can be used to augment its working capital funds. A firm having shortage of working capital or foreseeing liquidity crisis may exercise the option of selling the owned asset to a lessor and take it back on lease basis.

**d). Conserves borrowing capacity through OFF-THE BALANCE-SHEET financing:** Leasing is considered a 'hidden' form of debt in that the company can acquire the use of an asset without having the lease obligations appear as liability on its balance sheet. If the assets were purchased and

financed by borrowing, both the asset and borrowed funds would be shown in the firms' balance sheet. Traditionally leasing provides off-the-balance sheet financing keeping the firms' debt raising ability intact. The traditional accounting entries accompanying leasing make a company appear to be in a better borrowing position than a company that purchases equipment outright. (Samuels and Wilkis, op. cit. p. 311) The inclusion of debt in the balance sheet raises the debt equity ratio of the firm, which in turn restricts its future debt-raising capacity. In other words, the practice of omitting the lease obligations from being recorded in the balance sheet has a favorable effect on the financial position of the lessee firm.

**e). Tax benefit:** Lease payments, i.e. lease rentals made by the lessee are entirely deductible for tax purposes because lease rentals are treated as revenue expenditure and thus provide a greater tax benefit for the lessee in comparison to borrowing from banks. In order to avoid the hostile of explanation of source of fund to the income tax authorities for acquisition of capital assets, it is preferable to go for lease rentals. Particularly, in case of acquisition of cars as per existing income tax law, the cost of any such car valuing beyond Tk. 7.5 Lakh is not allowed as deductible expense. But under lease finance such expenditure is fully allowed.

**f). Hedge against inflation:** Payments of lease rentals are usually spreading over a number of years, so the real cost of acquisition can be reduced which acts as a hedge against inflation. In addition to the above benefits, leasing companies have special commitment of providing financial assistance through leasing to (1) all-level entrepreneurs for a wider range of asset acquisition from motor vehicles to large industrial machinery plant; (2) medium, small and micro-level entrepreneurs who have no easy access to commercial credit/loans for establishing small and cottage industries such as medium and small scale Textile looms, Printing and Packaging machinery, Handloom, Hatchery, Poultry, Fishery equipment, Power pumps, Power tiller etc.; (3) Engineers, Doctors, Technologists etc. who have technical knowledge but have lack of financial assistance for establishing small/micro enterprises/industries; (4) skilled and semi-skilled persons who have no employment opportunities or access to bank loans or other sources of fund for establishing light engineering workshop/small enterprises by providing lathe machines, welding machines and other required tools, Computers, Photo copiers, Type writers, Auto rickshaw, Van, Tampoo, Pick-up etc.

#### ***Weakness:***

**a). Risk of being deprived of the use equipment:** The lessee has only the right to use the asset but the ownership lies with the lessor. If the lessor's financial condition deteriorates or if the leasing company is wound up, the lessee may be deprived of the use of equipment interrupting its normal manufacturing operations.

**b). Alteration in the asset:** Under the lease, the lessee is generally prohibited from making alterations or improvements on the leased asset without the prior approval of the lessor. It may cause problem to the lessee if the lessor disapproves his plan of alternation. Moreover, the lessor may impose certain restrictive conditions, sometimes, regarding the use of the asset, say, number of hours the equipment may be put to use and so on.

**c). Terminal value of the asset:** In the case of assets, such as land and buildings, which have high terminal value at the end of the lease term, it would be more appropriate to own the asset than to lease it as the salvage value belongs to the lessor.

**d). Problem of evaluating credibility of lease-customers:** There is no credit information bureau or credit rating agency in our country. Respondents reported that Bank Statements, Audited Balance Sheet or Tax Return might be valuable source of information to judge financial solvency of the party. Auditors are not ethically sound. Accounts are manipulated by way of window-dressing and they cannot be accepted to show the real picture of the business (Khanam, 1995).

### **Problems Faced by Leasing Companies**

The development of leasing companies has been hindered by the absence of appropriate rules and regulations that are necessary for smooth operation of lease market. Leasing companies need a regulatory legal and fiscal environment that at least provides equal treatment compared with other sources of capital, investment and financing. The leasing companies can't spread its operation due to the unawareness about the lease financing among the manufacturers, traders and service companies. The leasing companies do not get funds from Government at lower rate of interest. Private Bank and development financial institutions get funds from the Government at the rate of 6% to 7% interests. Whereas IDLC procures long-term loan from nationalized commercial banks @ 11% to 12% interest. Cost of fund is high in case of IDLC in comparison with their counterparts i.e. banks and other financial institution (Khaleda, 1995). Some other problems are-

- (1) The leasing companies are falling into repossession problems;
- (2) Default-culture, which has plagued the country's banking sector, could threaten the leasing companies also. A substantial portion of the money advance to the users could become either doubtful or bad,
- (3) In Bangladesh the leasing companies faced competition from two areas (a) competition from traditional source financing and (b) competition from leasing companies. The major DFIs who provide term lending are all owned by government and majority of population still maintain their banking transaction with commercial banks, and
- (4) Leasing sector needs more attention both from Bangladesh Bank and Ministry of Finance so that they may have access to low cost credit lines for carrying on the leasing business with the objective to contribute to the overall industrial growth of the economy (Choudhury, 1999).

### **Problem Faced by the Lessee**

Lessees of leasing company in Bangladesh complained that the rate of interest charged by the company is higher. IDLC also charged higher service charge. Some of the lessees face problem with payment of rental. They think if the date is 1 to 5 days or 5 to 10 days, rather than specific dates, it will be helpful for payment. Lessees also feel that leasing company extends the period of lease term. The company usually permits lease term from 3 to 6 years. But for large-scale projects the periods should be longer (Khanam K, 1995).

### **Conclusion**

Leasing is relatively a new concept in Bangladesh. It is an innovative and alternative way of financing our commercial and industrial undertakings. Leasing business in Bangladesh has been miraculously developed during the short period of time. Due care should be taken both by the government and by entrepreneur to associate the development of lease financing in Bangladesh for the interest of economic development. Maintaining the IAS-17 to compare and make compliance among the leasing companies must bring out international harmonization of lease treatment. For the interest of the growth with equity a proper allocation is needed and now lease can solve the problem of the proper allocation of funds through lease financing.

Popularity of lease financing is due to tax advantages, timesaving and conservation of cash and funds. OFF-balance sheet financing opportunities provided by operating leases are an additional attraction of leasing. In addition to the lease sanctioning procedure, establishing effective working relationship with clients and continuous monitoring of leases ensure proper utilization of leased funds.

The ownership and organizational structure of prominent leasing companies greatly contribute to the success of leasing business in Bangladesh. Shareholding by institutional investors ensures separation of ownership from management, creates greater accountability and governmental influence.

The future challenges to the leasing business will come from increased competition in the lease market and the increased government intervention to relate the leasing companies. In fine, it can be said that leasing business will continue to grow in Bangladesh as a preferred means of acquiring equipment for its convenience and flexibility in financing. The volume of leasing business in this country will increase at a healthy rate.

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