ASSESSMENT OF LEASING PRACTICE IN TURKEY

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An analysis and assessment of past and current leasing practice in Turkey carried out in-depth utilising responses from a specially designed questionnaire completed by both lessors and lessees

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ABSTRACT

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Keywords: Equity Finance, Liquidity, Legislation, Lessor, Lessee, Off-Balance Sheet Financing, Value Added Tax (VAT), Useful Life, Internal Rate of Return (IRR), Net Present Value (NPV).

The present research investigates leasing practice in Turkey since 1985 and identifies various aspects of motivation and the factors influencing the leasing decision, and assesses the nature and extent of both lessors' and lessees' past, current, and future activities. Leasing is a relatively recent phenomenon in Turkey, but is now growing rapidly and approximately 40 active lessors account for about 2.5% of total fixed investment financing in the country.

The research indicates that there is no distinction between financial and operational leasing practice; all lease agreements are accepted as lease agreements without any distinction. The national market is somewhat fractured by size of transactions, region and asset types. The main barrier to entering the lease market is access to finance. The industry growth is quite high but the leasing market is not competitive enough and only a few leasing companies dominate the leasing market. The financial community is aware of leasing activities. Mainly bank-affiliated leasing companies enter the lease market, which clearly shows that financial institutions have taken steps to protect themselves from competition or to benefit from these activities where necessary.

The research also shows that different companies lease for different reasons. The main reason is 'full tax-deductibility', followed by 'improvement in flexibility of company funds' and 'conserving working capital'.

The research concludes that leasing as a method of financing has good future prospects and is playing an important role in the industrialisation of Turkey.

DEDICATION

TO MY PARENTS

IN LOVE AND GRATITUDE

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CHAPTER ONE

Introduction

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INTRODUCTION

1.1 INTRODUCTION

Although over the past four decades leasing has become an important method of obtaining the service of an asset as an alternative to outright purchase in all developed economies, it is not a modern phenomenon and was first used by the Sumerians some five thousand years ago.

Modern leasing began in the USA in the early 1950s, from the leasing of land to the leasing of housing, industrial equipment, and railroad equipment and has since then spread all around the world. By the mid-1960s, leasing as a financial practice had been established in most Western European countries and Japan, and the rest of the developed world during the 1970s. The establishment of the leasing industry in developing countries did not occur till the 1980s. Since then, leasing has taken on much importance. The 1980s was in fact the decade of the internationalisation of leasing.

The International Finance Corporation (IFC) has played an important role in propagating the concept of leasing in such developing countries as Brazil, Korea, Thailand, Indonesia and Turkey, through helping them to set up or actually being a partner. At the end of the 1980s, Bulgaria, Hungary and Poland also established their own leasing companies within former eastern bloc countries.

Today leasing is an important source of finance for a wide variety of capital assets in all major industrial nations of the world. Its market penetration is now above 20% in six countries such as the USA, Korea, Sweden, Portugal, Australia, and Ireland.

After the rapid growth of the 1960s and early-1970s, there was a steady growth in the 1980s which has now steadied in most of the countries where leasing was established early. In 1992 leasing activities in fact declined in 17 countries; these included Japan, the UK, France, Italy, Spain.

There are four major regional leasing organisations in the world concerned with the interests of leasing companies. These are :

Asialease stretching from India to Japan; Felalease, incorporating Latin American countries; the American Association of Equipment Lessors, covering the rest of the US; and Leaseurope, which embraces Europe and some other countries.

Leasing is understood in different ways in different countries, but the essential feature of leasing is the division of the use and the ownership of an asset. Thus, leasing is a method of financing the use of an asset without actually purchasing it. The owner of an asset (lessor) leases it to a customer (lessee) on a lease contract of periodical rental payments.

In the present study, the local definition of leasing is used, i.e. the definition in a particular country or region is used when discussing leasing in that particular area

From the definitions, leases come in many forms, but in all cases the lessee promises to make a series of payments to the lessor to use an asset for an agreed period of time. Within the general definition of a lease, every lease involves at least two parties, namely the lessor and the lessee.

The lessor is frequently a bank or a finance house, operating leasing business through a subsidiary or an independent leasing company. The lessees include industrial corporations, transport companies and service business. The common factor is that they pay lease rentals at regular intervals: monthly, quarterly, half-yearly or annual payments.

It is generally accepted that broadly there are two main types of lease; these are financial leases and operational leases. Other types of leasing arrangements also exist, but they are mostly a variation of either the operational or the financial lease

In financial leasing the role of the lessor is principally limited to the provision of finance to enable the firm to obtain the use of an asset. It is therefore carried out mainly by financial institutions, such as banks or their leasing subsidiaries. The lessee is responsible for insurance and maintenance of equipment.

Operational lessors are typically specialists in the type of asset they lease out and possess a detailed knowledge of equipment markets. The asset is purchased, maintained and insured by the lessor. Generally, under an operational lease the total payments made by the lessee to the lessor are less than the initial cost of the leased asset paid by the lessor

In contrast, the finance lease effectively transfers the risks and rewards of ownership to the lessee; with the operational lease these risks are borne by the lessor. The operational lease is therefore widely used for certain types of equipment, such as computers, motor vehicles, and heavy equipment

Generally, fiscal legislation does not make any distinction between the two categories of lease, the principal differences being:

1. Period of lease
2. Cancellation
3. Risk of obsolescence
4. Responsibility of maintenance
5. Types of assets

In considering leasing as an alternative to outright purchase, in the literature much attention is given to certain leasing issues such as

1. Whether a leasing decision is an investment or a financial decision.
2. To what degree leasing displaces debt.
3. What discounted rate should be used in assessing the leasing decision.

4. Reasons why companies lease.

There are many reasons why a company may choose to lease rather than purchase an asset. The relative importance of the reasons that enter into a lease decision vary from company to company and for each type of asset leased.

Each of the advantages may to varying degrees have an effect on the investment behaviour of firms. The decision to invest in or finance a project is likely to be influenced by a range of internal and external factors relating not only to past and present conditions but also to expectations of the future.

The economic environment in many countries has been relatively conducive to leasing. The uniqueness of the leasing mechanism, however, has been complicated by interaction between economic factors, tax legislation and accounting practices. Leasing has therefore followed different evolutionary forms of development as a result of different domestic conditions in different countries.

Both the lessee and the lessor, using independent criteria, have to evaluate the condition of the lease. Lease evaluation techniques can therefore serve different purposes. For the lessee, the main objective is to assess whether leasing is more attractive than outright purchase or an alternative financial lease. For the lessor, the objective is to ascertain that investment of capital in leasing is a better alternative than investing capital elsewhere. Again, lease evaluation techniques are necessary for the lessor to ensure that he can offer rental rates to the lessee which are attractive and competitive. In a free market it can be expected that a compromise is reached with an appropriate rate of return on capital for the lessor and rental rates for the lessee which are an attractive alternative to purchase.

Modern leasing can be considered a recent phenomenon in Turkey. With the encouragement of the International Financial Corporation, modern leasing practice was only introduced after 1985 with the Turkish Government Financial Leasing Law, and the first information regarding its activities appeared in 1987 (see Ilkorur, 1988, and Roberts and Burat, 1988). In 1987 there were only four financial leasing companies in Turkey; at the present time there are 39 companies.

The purpose of the introduction of leasing was to create an alternative mechanism for medium and long-term funding requirements for capital projects and consumer goods manufacturing where these were for the future economic development of Turkey. Domestic leasing is expected to channel domestic savings into productive investment, while cross-border leasing is expected to be instrumental in creating new sources of external finance for the growing needs of the Turkish economy.

Under leasing legislation, organisations in Turkey which are allowed to carry out leasing transactions include development and investment banks (D&IBs), private financial institutions (PFIs), and some Turkish branches or subsidiaries of approved foreign leasing companies.

According to the regulations of the Turkish Financial Leasing Law there is no distinction between financial and operational leases. All lease agreements contracted by rental leasing companies and empowered financial institutions in Turkey are accepted as lease agreements, regardless of any distinction.

On the other hand, lease agreements in Turkey can be divided broadly into two groups by markets: these serve domestic leasing and cross-border leasing.

With some exceptions, all leasing contracts normally must have a minimum term of four years and can not be terminated earlier.

Leasing companies in Turkey can be divided broadly into four basic types:

- Bank-affiliated leasing companies,
- Development and investment banks,
- Private financial institutions,
- Privately-owned leasing companies.

These four types of leasing organisations operating in Turkey belong to one or the other of two professional organisations, Leaseclub or FIKAD (Financial Leasing Research and Solidarity Association).

In Turkey there are general restrictions on the right to lease; lessors whose companies are established as a '*financial rental company*' and financial institutions empowered by the law, such as private financial institutions and development and investment banks, have a right to lease. But there is no limitation placed on either the lessee or the leased asset. Anyone, companies and individuals, can lease any type of movable or fixed assets.

The development of leasing and definitions are different from country to country, as are evaluation models used for the leasing-buy decision. Because different conditions and practices apply in different countries leasing decisions and policy can also vary from country to country.

1.2 THE NEED FOR THE STUDY

Although leasing has been practised since 1985, and has achieved spectacular growth and increasing importance as a source of finance for Turkish investors, no formal research on these activities in Turkey has previously been done. Therefore the researcher felt that there was a need for a study to ascertain the structure of the leasing industry and behaviour of decision makers. Also, to identify how companies evaluate the lease decision, and identify the past and current state of leasing practice which covers both the demand and supply sides of leasing in Turkey.

1.3 OBJECTIVES OF THE RESEARCH

The purpose of the research is to investigate leasing practice in Turkey and identify various aspects of motivation and the factors influencing the leasing decision, and to assess the nature and extent of both lessors' and lessees' past, current, and future activities.

From the lessors' point of view the research has the following objectives:

1. To assess the nature and performance of leasing companies active in the leasing business in Turkey.
2. To identify the type and volume of leased assets, and factors influencing general leasing business in the lease market.
3. To identify the relationship between leasing companies and lessees/ potential lessees concerning leasing transactions.
4. To discover the sources which leasing companies use to finance their leasing transactions.
5. To identify type and location of customers.
6. To show accounting practices and prospects for the leasing industry.

The objectives for the lessees' survey is to identify the behaviour of companies with respect to leasing, to try to understand why companies lease, and to present a general overview of leasing practice.

The lessees' survey was also designed to achieve the following objectives:

1. To identify the policy and attitudes of lessees and potential lessees towards leasing in Turkey.
2. To identify the type and volume of leased assets and factors influencing lessees' and potential lessees' decisions to lease.
3. To identify the relationship between leasing companies and lessees/potential lessees concerning leasing transactions.

1.4 RESEARCH LIMITATIONS

Limitations for the research are:

- There is no literature relating specifically to Turkish leasing practice, therefore the research mainly depends upon books and literature written in English in the USA and the UK.

- The study, of necessity, covers only a small time frame, in Turkey, of 1987 to 1992.

1.5 BASIC ASSUMPTION FOR THE RESEARCH

The research was conducted under the assumption that respondents of leasing companies and lessees/potential lessees would honestly provide information and data regarding their leasing activities and practices.

1.6 PERIOD OF THE RESEARCH

The study covers the period 1987 to 1992 inclusive. The year 1987 was chosen as the first year for the period of study since it is the first year in which leasing agreements were negotiated in Turkey. The latter date relates to the time when the questionnaires were mailed, April to August 1993.

1.7 PLAN OF THE THESIS

Chapter Two consists of two sections. The first section contains a review of the existing literature and relevant works on leasing, and examines the historical development of leasing and definitions used in different countries, together with models used for the leasing-buy decision.

The second section focuses on the development and growth of the Turkish leasing industry. This is reviewed from four perspectives:

1. How Turkish legislation promotes or inhibits leasing development.
2. Characteristics of the leasing industry.
3. Characteristics of leasing companies in Turkey
4. Legal and fiscal environment for lease practice.

Chapter Three presents the methodology used for collecting and analysing the data for this research. It discusses the design of both the lessors' and lessees' questionnaires and the selection and sampling criteria for companies, together with analysis and presentation of data.

Chapter Four contains the presentation and analysis of the data provided by the lessors' survey questionnaire which was designed and distributed to obtain specific information about leasing practices of leasing companies in Turkey.

Chapter Five concentrates on the presentation and analysis of the data provided by the lessees' survey questionnaire. The lessees' questionnaire was designed and distributed to obtain specific information about leasing practices in Turkey from the lessees' and potential lessees' point of view.

Chapter Six discusses results of the present research on leasing practice in Turkey from the point of view of both lessors and lessees/potential lessees. In addition to detailed discussion of leasing practices, discussion is also directed to identifying the relation of lessors and lessees, together with factors affecting their decision to lease or not.

Chapter Seven summarises the main conclusions drawn from the analysis and interpretation of the data from both the lessors' and lessees' questionnaires and makes recommendations for further research.

CHAPTER TWO

SECTION (1)

Evaluation and overview of general leasing practice

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SECTION (1)

EVALUATION AND OVERVIEW OF GENERAL LEASING PRACTICE

2.1.1 INTRODUCTION

Leasing, jointly a method of financing and a method of acquiring an asset, outside Turkey, has developed rapidly in the past four decades. Now it is an important source of finance for a wide variety of capital assets.

Modern leasing began in the USA in the early 1950s, then spread to Europe and Japan in the early 1960s and the rest of the world during the 1970s. The 1980s was the decade of the internationalisation of leasing. The 1980s saw leasing become recognised as a universally accepted method of capital equipment acquisition in all major industrial nations of the world.

The development of leasing activity in the United States spread from the leasing of land to the leasing of housing, industrial equipment, and railroad equipment.

Leasing is understood in different ways in different countries. However, in many countries it is synonymous with or the same as hire purchase, but the essential feature of leasing is the division of the use and the ownership of an asset. Thus, leasing is a method of financing the use of an asset without actually purchasing it. The owner of an asset (lessor) leases it to a customer (lessee) on a lease contract of periodical rental payments.

"Fundamentally, the lease contract bestows on the lessee only a limited right, namely the right to *use* the asset for the fixed period of time, in exchange for the fixed payment". (Weingartner, 1987)

The lessor is frequently a bank or a finance house, operating leasing business through a subsidiary. There are also a large number of independent leasing companies. The lessees include industrial corporations, transport companies and service business. The common factor is that they pay lease rentals at regular intervals; monthly, quarterly, half-yearly or annual payments are the most common.

The rapid growth in the leasing industry over the past 30 years is attributed, by Pike and Dobbins (1986), to four factors:

1. Tax structure.
2. The inability of capital markets to provide funds for new investments.
3. The fixed-lease payments can turn out to be very cheap if interest rates rise.
4. Leasing is 'off-balance sheet' financing.

2.1.2 DEVELOPMENT AND GROWTH OF LEASING

Although leasing has been used since the ancient times, it is only since World War II that it has become a major financial activity.

In the period that followed World War II to the present time, methods of financing and industrial manufacture have become highly sophisticated; within this context leasing has found its place as a flexible and widely used financing tool.

2.1.2.1 Early history

Leasing as an accepted business practice has gained so much importance in all developed nations that a considerable proportion of all business now uses this method of financing. Before going on to describe modern leasing practices it is appropriate to refer briefly to the historical development of leasing.

Clark (1978) says that " Several European writers have pointed to 1877 as the date of the first appearance of equipment leasing in modern times, being the year that the Bell Telephone Company began renting telephones in the United States." But this is not to say that the United States is the original home of modern leasing business. As Clark (1978) documented, UK wagon-leasing companies operating in the late-1850s were amongst the very first registered limited liability companies in the UK.

Historically, there are various references to the origin of leasing as a way of conducting business in different countries and each era has its own kind of leasing conditioned by social, economic, financial and technical structures. Principally, leasing is not a modern phenomenon. According to Livijn (1988) the oldest leasing documentation can be found in Sumerian (Southern Iraq) clay tablets, 3000 BC. It may also be possible that leasing existed elsewhere without any such documentation and was practised long before 6000 BC. According to Sumerian documents, agricultural fields, animals – mostly oxen – were leased, as well as ploughs and other equipment.

Chronologically, it is difficult to trace the evolutionary process but some available sources may be referred to with advantage. Pierce (1975) points out that more than 900 years ago, during the reign of William the Conqueror, " the Manor of Aldenham was leased from the Abbot of St. Albans by the Abbot of Westminster for a period of twenty years at the rent of 100 shillings." This lease is an example of a financial lease and is no different in concept from leases being contracted today. He also points out that the history of lease law began with Roman Law which was the basis for the English Common Law. Leasing of land and buildings was also popular in the Middle Ages.

According to Ellahi (1988) leasing practices were prescribed as far as 1400 years ago by Islamic Law. "With a few exceptions, both operation and finance lease, as we know them today, have been extensively used for financing capital assets in the Islamic economic system. The operation leases are called "Ijara" and the finance leases "Ijara Wa Iktina" ".

2.1.2.2 Modern growth of leasing

In 1952 the first modern leasing company, the United States Leasing Corporation, was set up in the United States. During the 1950s, jet-engines, commercial aircraft, computers and other new and expensive generations of capital equipment became available to American industry for the first time through leasing. High demand for expensive capital equipment created an ideal environment for the rapid growth of leasing.

From the USA the concept of leasing rapidly opened up throughout the developed world. US leasing was an important factor in this dissemination. For example, in 1959 US Leasing Inc. participated in a joint venture leasing company in Canada called Canadian Dominion Leasing Corporation. In 1960 the first British leasing company, Mercantile Leasing, was established, and one year later leasing companies were established for the first time in Italy and France. The company Dutch Leasing was established in Germany, in 1962, and Orient Leasing in Japan, in 1963 (World Leasing Yearbook-WLY- 1989). Several Australian leasing companies were also set up in the early 1960s. By the mid-1960s, leasing as a financial practice had been established in most Western European countries.

In some countries, such as the USA, Canada, UK and Australia, a favourable tax environment further stimulated the growth of leasing.

The establishment of the leasing industry in developing countries did not occur till the 1980s. Since then, leasing has taken on much importance in such countries as Brazil, Korea, Thailand, Hong Kong, Singapore, Indonesia and Turkey.

Table 2.1.1

IFC leasing investments

Country	Year of IFC board approval	Total number of companies	IFC total loan and equity ($US 000)
1. Korea	1977	1	15621
2. Thailand	1978	5	1447
3. Philippines	1979	1	10940
4. Sri Lanka	1980	1	3338
5. Colombia	1980	1	1939
6. Jordan	1981	1	289
7. Peru	1981	2	14637
8. Indonesia	1981	3	9891
9. Brazil	1982	1	30450
10. Portugal	1982	1	12733
11. Ecuador	1983	1	3350
12. India	1983	8	46908
13. Dom. Rep.	1983	1	3195
14. Zimbabwe	1984	1	2602
15. Tunisia	1984	1	3431
16. Bangladesh	1984	1	2535
17. Pakistan	1984	2	10377
18. Swaziland	1985	1	1950
19. Malawi	1985	1	715
20. Turkey	1987	2	6100
21. Botswana	1988	2	893
22. Chile	1990	1	10000
23. Ghana	1991	2	11150
24. Czech. Rep.	1992	1	580
25. Morocco	1993	4	35000
26. Oman	1993	1	5520
TOTAL		47	240191

Source: World Leasing Yearbook, 1994

The International Finance Corporation (IFC), an affiliate of the World Bank, has played an important role in propagating the concept of leasing in developing countries through helping to set up or actually being a partner in what was a joint venture company. IFC chose Korea for its first venture, and in the mid-1970s the Korea Development Leasing Corporation was set up (see Table 2.1.1). Barger and Mengistu (1994) reckon that in the 17-year period between 1977 and 1993, IFC has helped establish 47 equipment leasing companies in 26 different countries, of which 22 were in Asia, 11 in Europe and the Middle East, seven in South America and seven in Africa. IFC's total current equity investment in these companies is about $US 20 million and its loan to the investee companies about $US 220 million.

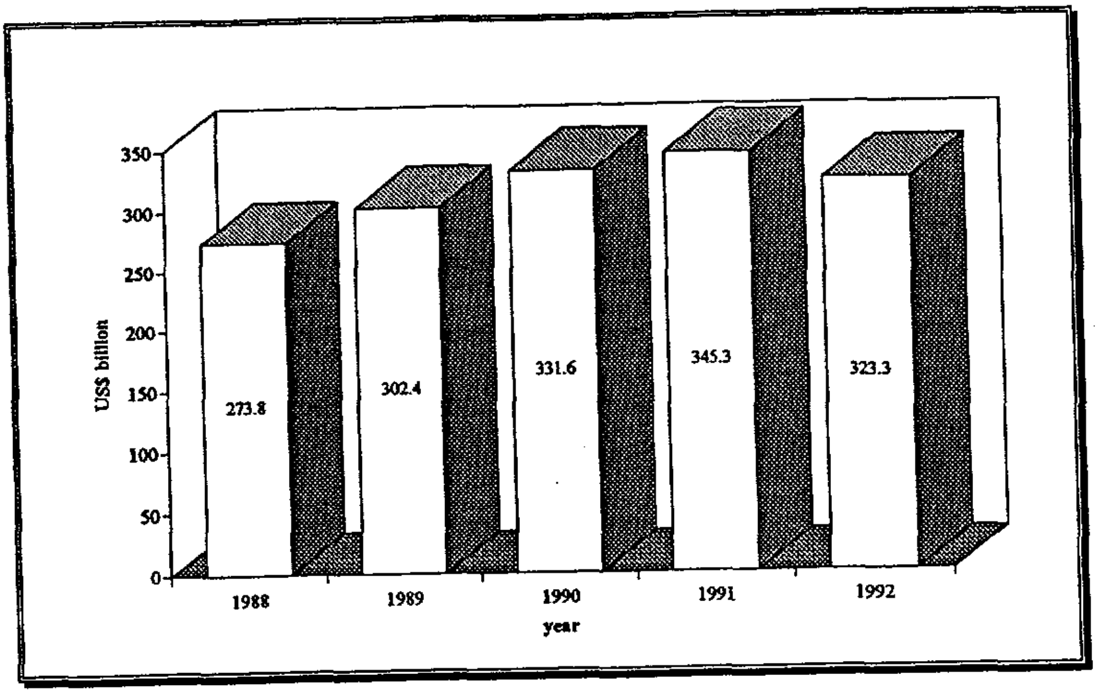
At the end of the 1980s, Bulgaria, Hungary and Poland established their own leasing companies within former eastern bloc countries.

Leasing is now accepted in most economies as a suitable and creative financing source for acquisition of capital equipment. Increasing awareness of the advantage of the applications of leasing means that leasing has secured a place in the financing practice of business growth. The rapid growth of the 1960s and early-1970s has now steadied in most of the countries where leasing was established early, because the business is maturing and reaching its natural level in relation to total requirements of capital investment. The 1980s have now seen leasing become recognised as a universally accepted method of capital equipment acquisition.

The World Leasing Yearbook 1994 gives figures for the total world volume of leasing activities for the years 1988-1992. These are reproduced below (Figure 2.1.1).

Figure 2.1.1

Volume of world leasing



Source: World Leasing Yearbook 1990, 1991, 1992, 1993, 1994

It is seen that whilst there is a steady growth in the years 1988-1991, there is a drop of 6.7 % for the year 1992. The yearbook attributes this largely to : "the large drop in business levels in Europe in 1992 where volume fell 17% to $US 99.5bn from $US 120bn as a result of the deepening economic recession and its consequent impact on capital equipment acquisition programs." It will be interesting to see when the figures are eventually available if they show a decrease in 1993 and 1994 or signs of recovery from the world economic recession. The global leasing industry was up around 4.1 % in 1991, and 9.7% in 1990, which compares closely to the increase to 10.66% in 1989, but contrasts with an average rate of increase of 22.5% per annum over the 1983-1988 period.

Some important trends are indicated in Table 2.1.2; in particular it shows that in 1992 leasing activities declined in 17 of the 50 countries; these include Japan, the UK, France, Italy, Spain, Indonesia and Peru. In three countries, the USA, Malaysia and Ecuador, the volume of leasing business however remained unchanged in relation to the previous year 1991.

It is interesting to further note that market penetration is now above 20% in six countries: the US, Korea, Sweden, Portugal, Australia, and Ireland.

There are four major regional leasing organisations in the world concerned with the interests of leasing companies. These are :

Asialease (established in May 1982), stretching from India to Japan; Felalease (in 1983), incorporating Latin American countries; the American Association of Equipment Lessors, covering the rest of the US; and Leaseurope, which embraces Europe and some other countries.

Table 2.1.2 TOP 50 LEASING COUNTRIES Volume, Growth and Market Penetration 1992 - Ranked by Volume				
Rank	**Country**	**Annual Volume ($US bn)**	**% Growth 1991-1992**	**% Market Penetration**
1	United States	120.30	0.0	32.0
2	Japan	62.76	(11.7)	7.5
3	Germany	31.67	15.0	16.6
4	France	14.22	(14.4)	14.6
5	Italy	12.76	(30.5)	11.5
6	Great Britain	12.28	(31.0)	18.6
7	Korea	8.45	28.0	20.0
8	Spain	6.36	(28.6)	17.5
9	Canada	4.81	27.7	11.0
10	South Africa	4.44	16.0	n/a
11	Sweden	4.22	(0.5)	26.3
12	Brazil	4.10	46.0	n/a
13	Netherlands	4.10	17.4	10.5
14	Australia	3.88	23.0	20.0
15	Hong Kong	2.97	35.3	n/a
16	Austria	2.85	(10.5)	16.9
17	Mexico	2.50	25.0	5.0
18	Belgium	2.00	(9.5)	7.0
19	Switzerland	2.00	(26.1)	11.0
20	Portugal	1.92	20.9	20.4
21	China (People's Rep.)	1.90	26.7	1.2
22	Indonesia	1.81	(5.4)	n/a
23	Ireland	1.16	(2.9)	32.0
24	Venezuela	0.87	21.6	n/a
25	Taiwan	0.78	11.3	11.0
26	Denmark	0.77	(31.4)	11.0
27	Malaysia	0.70	0.0	n/a
28	Hungary	0.68	272.0	18.0
29	Czech Republic	0.60	139.1	17.5
30	Colombia	0.57	87.6	8.2
31	Chile	0.50	70.9	16.0
32	India	0.50	15.0	5.0
33	Norway	0.46	11.4	4.7
34	Turkey	0.42	61.5	2.6
35	Finland	0.41	(20.4)	7.0
36	New Zealand	0.32	3.2	n/a
37	Singapore	0.28	(5.7)	n/a
38	Pakistan	0.26	35.0	3.0
39	Greece	0.25	44.6	4.2
40	Luxembourg	0.21	38.0	n/a
41	Morocco	0.18	6.4	2.6
42	Thailand	0.18	(37.9)	n/a
43	Israel	0.17	22.0	n/a
44	Ecuador	0.13	0.0	5.0
45	Peru	0.12	(14.3)	n/a
46	Botswana	0.12	23.3	n/a
47	Poland	0.10	42.9	2.6
48	Philippines	0.09	5.6	18.7
49	Sri Lanka	0.07	57.1	n/a
50	Nigeria	0.05	(28.5)	n/a

Source : World Leasing Yearbook 1994

Percentage growths and market penetrations are represented for individual countries for the year 1992 in Table 2.1.2. Market penetration is defined as the percentage of all capital investment represented by leasing.

2.1.2.2.1 Leasing in North America

The region which is defined as North America includes Panama and all the countries north of it, and includes the USA, Canada and Mexico.

From the early-1960s, accelerated depreciation allowance and Investment Tax Credit in the USA made tax-based leasing attractive. By 1963 a large number of lessors were established by both banks and commercial and industrial corporations.

Although the US share of the world leasing market fell to 36 % in 1992, from 50% in 1983 and 40.5% in 1989 , the US industry still transacted almost twice as much as leasing business as Japan, which has the world's second largest leasing industry, and the volume of leasing in the USA is greater than the total leasing business of Western Europe.

Canada and Mexico have sizeable and growing leasing industries; the Canadian leasing industry started to decline by 1989 largely due to adverse tax changes. Its leasing volume dropped to $US 43.15bn in 1990 from $US 3.92bn in 1988. According to Koflowitz (1992)

> "The annual survey conducted by Statistics Canada reported that the net value of leases written in 1991 totalled C$4.7 billion, while this represented a five per cent increase over 1990s $C 4.5 billion volume."

According to WLY 1994 (Canada section), a survey conducted by Statistics Canada for the Canadian Finance and Leasing Association showed the net value of leases written in 1992 was $C 6.1, a very respectable 30 % increase over 1991, this volume despite a general world recession. The industry regained the ground lost in market penetration in 1989, accounting for 11 % of total capital expenditure on equipment in 1992. It is still a relatively small proportion compared with that in other industrialised countries such as the US, where penetration is upwards of 30 % of capital equipment requirements. It is of interest to note however that membership of the Equipment Lessors Association of Canada (ELAC) fell by about 25 % to 47 at mid-year 1992 from 61 in 1989.

Increased performance in Mexico is even more outstanding than that of Canada. From 1987 to 1991 the number of leasing companies rose from 14 to 50, which is an average annual growth of 38 %, corresponding to an increase in leasing volume of $US 149 million in 1987 to $US 3.7bn in 1991 (Marray 1993).

There are also leasing industries in this region in Panama, Costa Rica, Honduras, Dominican Republic and Caribbean countries, but their volume of business is small.

However, North America's share of the world leasing market dropped from 41.9 % in 1989 to 37.6 % in 1991. Nevertheless, did start to regain its market share with an increase of 1.9 % to 39.5 % in 1992, although its total volume for 1992 dropped by 1.9 % (see Table 2.1.3).

Table 2.1.3

Leasing volume and growth by region

Region	Annual volume ($US bn) and percentage of world market(%)				
	1988	1989	1990	1991	1992
North America	117.0 (42.7%)	126.8 (41.9%)	125.4 (37.8%)	130.0 (37.6%)	127.6 (39.5%)
Europe	80.1 (29.3%)	98.0 (32.4%)	117.9 (35.5%)	120.0 (34.7%)	99.5 (30.8%)
Asia	63.6 (23.2%)	65.3 (21.6%)	77.5 (23.4%)	83.4 (24.2%)	80.9 (25.0%)
Australia and New Zealand	7.1 (2.6%)	7.3 (2.4%)	5.1 (1.5%)	4.0 (1.2%)	4.2 (1.3%)
Africa	2.8 (1.0%)	3.0 (1.0%)	3.8 (1.2%)	4.4 (1.3%)	4.8 (1.5%)
South America	3.2 (1.2%)	2.0 (0.7%)	1.9 (0.6%)	3.5 (1.0%)	6.3 (1.9%)
Total	273.8	302.4	331.6	345.3	323.3

Source: World Leasing Yearbook 1990, 1991, 1992, 1993, 1994

2.1.2.2.2 Leasing in Europe

Growth was relatively strong in Europe where the financial sponsors of the earliest leasing companies were banks and other large financial institutions. As Table 2.1.3 shows, leasing grew faster in Europe than in any other region by the end of 1990. In Western Europe leasing has been growing at a faster rate than any other form of finance. The Europeans have well-developed, mature markets which are growing solidly year by year. The European market is dominated by a core of five countries: Germany, Great Britain, France, Italy and Spain. Together, these countries account for over 77 % of the total volume of leasing in Europe (for more detail see Table 2.1.4). The UK was the largest, followed closely by Germany and France, but the latest figures released by Leaseurope show that Great Britain had lost its leading position to Germany by 1992. Again, the total European market fell by 17.1 % per cent to $US 99.5 billion from $US 120.0 billion in 1991.

In large , mature industries in France, Italy, the UK, and Spain, the volume of leasing dropped in 1992. Of the European countries with large economies, including Germany (15%), The Netherlands (17.4%) and Portugal (20.9%); in contrast, the recorded growth value of leased equipment increased just in 9 of 23 countries which have Leaseurope members. The highest growth rates in 1992 were registered in Czechoslovakia (139.1%), Greece (44.6%), and Luxembourg (38.0%). Small falls in new business were registered in Sweden (0.5%) and Ireland (2.9%).

According to the 1994 World Leasing Yearbook, 5 of the first 10 countries ranked by volume are Western European nations and annual growth of the European leasing industry was over 20% for the three years 1988, 1989,1990. According to the annual survey conducted by Asset Finance & Leasing Digest (AF&LD), in February 1993 (Kapoor, pp.6-14), 6 of the 10 largest world's lessors by annual volume are from the UK, France and Germany (two in each country).

Table 2.1.4
Equipment leased in Europe

	ECU millions		
Country	**1992**	**1991**	**1ECU=Units**
Austria	1,899	2,122	14.225
Belgium	1,512	1,671	41.606
Bulgaria	10	11	30.303
Czechoslovakia	416	174	36.958
Denmark	485	707	7.812
Finland	305	383	5.802
France	11,214	13,100	6.85
Germany	19,050	16,561	2.021
Greece	201	139	246.09
Hungary	459	-	104.57
Ireland	841	866	0.761
Italy	9,337	13,426	1,594.28
Luxembourg	167	121	41.606
Morocco	149	140	10.181
Netherlands	2,830	2,441	2.276
Norway	342	307	8.045
Poland	84	-	17.445
Portugal	1,557	1,288	174.687
Slovenia	29	25	100.474
Spain	5,120	7,170	132.442
Sweden	2,778	2,792	7.537
Switzerland	701	948	1.82
UK	16,022	18,081	0.737
Total:	75.508	82.443	

Source: Asset Finance & Leasing Digest, June 1993

2.1.2.2.3 Leasing in Asia

Right from the start of its introduction to Asia (Japan) in the 1960s, the concept of leasing finance has been popularly recognised as an innovative means of equivalent financing and an important tool in the economic development of a country. The Asian sector grew rapidly in the 1980s and has now developed into a sophisticated market with particularly strong growth in Korea and Hong Kong.

In five countries (Bangladesh, Pakistan, Republic of Korea, Sri Lanka, and Thailand), IFC was involved as a founding shareholder in the first leasing companies.

To contribute to the broadening and upgrading of leasing services and afford the opportunity for the member countries and corporations to share their experiences, the Asia leasing association, Asialease, was set up in 1982 by the leading companies in the region.

Porter (1993) cited that some 17 Asian countries included in the *Global Leasing Report* have leasing industries, 14 of which are ranked by volume in the world's top 50 (in 1994), while leasing volumes of Bangladesh, Iran and Oman had ranking outside the 50

The volume of leasing in Asia increased by 31.1% to $US 83.4bn from $US 63.6bn during the period of 1988 to 1992.

The Japanese market, started in 1963, is the second largest market after the USA, and dominates the Asian leasing statistics. But it is not the only dynamic leasing industry in Asia. The Korean leasing industry doubled its volume to $US 8.45bn from 1988 to 1992, and ranked 7th in the world. During the period 1983-1990, the leasing industry in Korea has grown remarkably, recording an annual average growth rate of more than 40%. High growth rates were also recorded for Hong Kong, China, and Indonesia.

The leasing industry started in India in 1973 and by the end of 1984 had hundreds of leasing companies primarily focused on small-value equipment. Countries in and around the Indian sub-continent made good progress in 1992. The Indian leasing industry grew by 15%, Pakistan by 35%, and Sri Lanka by 57.1%.

In the fiscal year 1992, the Japanese leasing industry saw its first contraction in investment with growth down 12% from the previous year. According to Nagano (1993), the recession has taken its toll in reduced investment in all industries. Equipment leasing accounts for about 8% of total capital expenditure in Japan. That country's 1992 volume of $US 62.76bn was 11.7% down on the previous year and because of Japan's dominance of the Asian leasing statistics (about 80 %), Asia as a region declined by 3 % in 1992.

According to McBain and Valentine (1994), by mid-1993 61 domestic specialised leasing companies were operating in China and 27 Sino-foreign Equity Joint Ventures (EJV), independent Chinese legal entities established by the Chinese and foreign investors of which the foreign contribution must comprise at least 25 % of such registered capital in the form of cash or equipment or / and technology. The EJV is currently the most popular vehicle for providing foreign investment in China, with over 58,000 companies having been established by the end of 1992. There are also 370 other institutions which are engaged in leasing subsidiary to their main activities, such as banks, trusts and investment corporations. Haiboa (1992) points out that the cumulative lease portfolio in China from 1981 to 1990 was around $US 4 billion (excluding aircraft). From its inception in 1981 the Chinese leasing industry has grown gradually. The lease portfolio was estimated to be in the region $US 1bn in 1991 and $US 1.6bn in 1992 (excluding aircraft). In the case of aircraft, China imported 76 aircraft with a value of $US 3.496bn in the period 1991-1993.

2.1.2.2.4 Leasing in Africa

The African continent is only starting to develop as a leasing market and is another region with enormous growth potential and world-wide has the second greatest percentage growth in leasing. The average annual growth rate in the region was 14.7 % for 1988 to 1992, and the volume of leasing business went up to $US 4.8bn from $US 2.8bn in the same period.

New leasing business has been established with the encouragement of the IFC which has recently expressed an interest in assisting in the establishment of new leasing ventures in Egypt and Algeria.

The South African Republic leasing market, which is the largest in Africa, rose to 10th place in world volume terms in 1992 ($US 4.44bn), with a growth of over 16 % from when it was in 11th place in 1991. The total growth rate of this country between 1988 and 1992 was 67.5 %.

However, although a leasing industry does exist in several African countries, such as Zimbabwe (since 1965), Nigeria and Malawi, only two countries besides South Africa are included in Table 2. Each of them had growth well above the average for the rest of the Africa, Botswana 23.3 % and Morocco 6.4%.

The Moroccan leasing industry grew by 200 % from 1988 to 1992 and continues to rank in size second after South Africa in Africa.

2.1.2.2.5 Leasing in Australia and New Zealand

Leasing finance in Australia rose strongly through the 1960s, 1970s and into the 1980s. The proportion of new private capital expenditure leased peaked in 1988/89 at about 30 %, with volume of business of $US 7.27bn.

According to a survey, in contrast, conducted on Asian lessors by AF&LD in May 1993, (Kapoor, pp.37-41) covering Asia and Australasia, 4 out of the 10 biggest companies by annual volume size, and 6 out of 10 by portfolio size, are Australian; the economic recession and its negative impact on investment caused a substantial decline in leasing activity in Australia since it reached its peak in 1989. This drop, according to Dore (1993),

> " was caused, not only by the recession, but by lessor tax accounting changes in July 1990, a more flexible and popular commercial hire purchase package and the distorting impact of state stamp duties".

As a percentage of equipment capital expenditure, leasing had fallen from about 33% in 1989 to 20% at the end of 1992. In volume terms, leases dropped about 53 % to $US 3.9bn from the peak of $US 7.3bn. Australia went down by this drop from 8th to 14th rank in 1992.

According to Porter (1992),

> "Relatively little leasing of equipment takes place in New Zealand. There is no national association and the New Zealand Government Department of Statistics generates no data on leasing. Estimates are available, however, for the motor industry where vehicle leasing increased by about 10 % to $NZ 550m in 1990"

The volume estimate used in the *Global Leasing Report* for New Zealand shows leasing business, which covers mainly motor vehicles and office equipment, increased by about 50% annually to $US 0.32bn in 1992 from $US 0.06bn in 1988.

Although the regional leasing volume for Australasia increased to $US 4.2bn in 1992 from $US 4.0bn in 1991, as a percentage, 1.3% of the world market was well below the peak year of 1989 (see Table 2.4).

2.1.2.2.6 Leasing in South America

The IFC provided a particular stimulus to the Latin American markets in the early-1980s. In Peru and the Dominican Republic the IFC was involved as a founding shareholder in the first leasing company. However, in Brazil, the IFC encouraged leasing companies only to satisfy specific markets, such as agriculture.

The regional leasing association, Felalease, was established for Latin America in 1983. According to Bornia (Biderman, 1993), by 1988 the Brazilian market, the largest leasing market in South America, which is mainly for vehicles, machinery and equipment, accounting for 75% of total

Brazilian leasing, and the Venezuelan, the second largest market by volume, started to decline. In spite of this, 1989 and 1990 saw growth in Chile, Colombia and Ecuador, though drops were experienced in Brazil of 39 % and 6 %, with a dramatic decline in Venezuela of 51 % and 55 %, resulting in a 5 % contraction for this region in 1990 and 37 % in 1989.

After suffering a decline for several years, the South American leasing industry now has the most spectacular growth in the world. Leasing volume increased by 84 % in 1991 and 80 % in 1992, though the regional share of 1.9 % of the total world leasing by volume is still small.

Leasing as an accepted economic activity or a form of business has clearly gained universal acceptance in a short time. The phenomenal rates of growth in leasing for various regions is certainly an indication of the uniqueness of this form of business.

2.1.3 DEFINITION OF LEASING

The most important distinguishing feature of leasing as a source of finance for capital investment is the separation of ownership and use of an asset. There is no internationally recognised definition of leasing; in fact, the definitions vary from country to country. It is understood in different ways in different countries. Leasing in many countries is similar to, or the same as, hire purchase in the UK. In some countries the two concepts are very different.

2.1.3.1 General definition

In leasing the first rule to observe is that the ownership of the item being financed is vested in the lessor (owner) and the right of use is vested in the lessee (user) in exchange for a specified payment over an agreed period of time.

In the present study, the local definition of leasing is used, i.e. the definition in a particular country or region is used when discussing leasing in that particular area. So, lease in France is equivalent to hire purchase in the UK, or conditional sale in the US.

According to Mayes and Nicholas (1988), the general definition of leasing is that

> " in return for specified payments (rentals) the owner of the asset (the lessor) grants exclusive use of it for an agreed period to the hirer (the lessee). Leasing is thus a method of financing the use of an asset without actually purchasing it. The fundamental characteristic of a leasing agreement is the division of the use and ownership of an asset into distinct legal and economic activities."

Grant and Gent (1992) define lease as

> " a contract between a lessor and a lessee for the hire of a specific asset. It is a feature of such contracts that title to the asset remains with the lessor, but that the right to use the asset is afforded to the lessee in return for the payments of rentals. The definition is extended to contracts in which one party retains title to the asset but permits another party to use it in return for specified payments. Thus, hire purchase contracts fall within the definition."

According to Knott (1991), leasing is " yet another way of financing the use of an asset without having to pay its full cost immediately."

Gitman (1976) has defined leasing in the following words:

> " Leasing involves obtaining the use of specific fixed assets, such as land and equipment, without actually receiving title to them. The lessee receives the service of the assets leased to him by the lessor, who owns the asset. In exchange for the use of the assets the lessee pays the lessor a fixed periodic payment, which is normally made in advance of each lease period. The lease payment is treated as a tax-deductible expenditure by the lessee; lease receipts are treated as revenues by the lessor."

According to Hampton (1977), leasing is

> " ...an agreement that provides a firm with the use and control over assets without receiving title to them. A lease is the written agreement allowing for the use of assets for a specified period of time. The lease is signed by both owner of the assets, called lessor, and the user, called lessee." (Karuppiah, 1988, pp.15-16)

The International Accounting Standards Committee (IASC) has defined a lease as (IAS No: 17)

> " an agreement, whereby the lessor converts to the lessee in return for rent the right to use an asset for an agreed period of time."

IAS 17 classifies lease under two headings: a finance lease, defined as a lease which transfers substantially all the risk and rewards incident to the ownership of asset, whether or not title is eventually transferred, and operating lease which is any lease other that a finance lease.

In general, a lease contract is a contract between the lessor and lessee for the hire of a specific asset. The lessor retains the legal title of the leased asset, but assigns the right of the use to the lessee in return for periodic payments for rental.

According to all the definitions above, leases come in many forms, but in all cases the lessee promises to make a series of payments to the lessor to use an asset for an agreed period of time. Within this general definition of a lease every lease involves at least two parties. The user of an asset is called the lessee and the owner of an asset is called the lessor. Also, an understanding of the various types of lease is important because accounting, taxation and regulations differ according to the type of contract, although they may have the same legal characteristics. It is generally accepted that broadly there are two main types of lease; these are financial leases and operational leases.

2.1.3.2 Financial leases

A finance or financial lease can also be called a capital lease, full payout lease, or net lease.

The following definition of a financial lease is given by Van Horne (1971):

> " A financial lease is a non-cancellable contractual commitment on the part of a lessee to make a series of payments to a lessor for use of an asset. The lessee acquires most of the economic values associated with the outright ownership of the asset, even though the lessor retains title to it."

Vancil (1961) defines a financial lease as

> " a contract under which the lessee agrees to make a series of payments to the lessor which, in total, exceed the purchase price of the asset acquired. Payments under the financial lease are spread over a period of time equal to the major portion of the useful life of the asset acquired. During this initial term of the lease, the contract is non-cancellable by either party ".

Financial leases are a source of financing; signing a financial lease contract is like borrowing money, because after the contract there is an immediate cash inflow that the lessee is relieved of having to pay for the asset (Brealey and Myers, 1988, p. 630).

A financial lease is in general a longer-term lease than, to be discussed next, an operational lease. Financial leases are non-cancellable and total payments over the lease period are greater than the cost of leased assets to the lessor (Gitman, 1976, p. 470).

Fawthrop and Terry (1975) define financial leasing as follows :

> "A contract involving payment over a specific period, of a sum sufficient to amortise the initial outlay and associated cost of the lessor plus his profit. This obligatory, or 'primary', period is generally less than or at the most equal to, the estimated useful life of the asset. Once this primary period is completed, the lessee may negotiate for a secondary period of usage of the asset, generally at something of a nominal period rental. The primary lease involves a major unavoidable future commitment of cash-flows, as it cannot be cancelled. Nor, usually, can it be made the subject of a major revision in the terms."

In finance leasing the role of the lessor is principally limited to the provision of finance to enable the firm to obtain the use of an asset. It is therefore carried out mainly by financial institutions, such as banks or their leasing subsidiaries. The lessee is responsible for insurance and maintenance of equipment (Nunnally et al. 1991). Although legal ownership remains with the lessor in financial leases, it is similar to purchase using other forms of instalment payment.

2.1.3.3 Operational leases

Operational lessors are typically specialists in the type of asset they lease out and possess a detailed knowledge of equipment markets. The asset is purchased, maintained and insured by the lessor. Generally, under an operational lease the total payments made by the lessee to the lessor are less than the initial cost of the leased asset paid by the lessor. In other words, the operational lease is frequently not fully amortised. Since the operational lease is normally for a period less than the asset's usable life, the lessor is expected to be able to sell the asset when the lease ends.

According to Nunnally et al. (1991), an operational lease is characterised by the following :

1. The duration of the lease is usually for a time period shorter than the economic life of the asset.
2. An operational lease is of a shorter duration than the financial lease.
3. The lease is cancellable if the lessee gives proper notice.

Hubbard (1980) points out the responsibility of the lessors in operational leasing as follow :

1. The lessor is normally responsible for the repairs, maintenance and insurance.
2. The risk of obsolescence lies with the lessor.
3. The residual value of the asset at the end of the lease is important to the lessor.
4. The lessor needs to be technically knowledgeable about the asset, because his profit comes partly from his ability to re-lease the asset in the future, and also because he may be responsible for the repairs and maintenance.

The residual value of the asset is consequently of considerable importance and, because of the alternatives of re-leasing or selling available to the lessor, an operational lease is not normally difficult to cancel. In contrast, the finance lease effectively transfer the risks and rewards of ownership to the lessee; with the operational lease these risks are born by the lessor. The operational lease is therefore widely used for certain types of equipment such as computers, motor vehicles, and heavy equipment (Myers and Nicholas, 1988), where the technological development is rapid, and financial leasing is used for railway, aircraft and items of high capital value.

Jatim (1993) states that, based on the definition of the Indonesian government, an operational lease is :

1. A lease that is not a full pay lease (taking a residual value).
2. A lease contract that does not specify a purchase option by lessee.

3. The lease contract term is lower than that specified as the minimum economic life of an asset.

2.1.3.4 Common factors and differences between financial lease and operational lease

Common factors applying to both financial and operational leases are:

- Allow the lessee use of an asset for an agreed period of time without actually purchasing it.
- The lessee promises to make a series of payment to the lessor for a specified period.
- The title of the asset remains with lessor.

Generally, fiscal legislation does not make any distinction between the two categories of lease; principal differences are :

1. Period of lease

- The financial lease term usually covers the useful life of the asset.
- Operational lease contract periods range are generally less than the economic life, can be short or intermediate in nature, and a particular asset can be the subject of several consecutive leases during its life time.

2. Cancellation

- Unlike operational leases the financial lessee can not cancel prematurely a lease contract.

- Operational lease contracts are usually cancellable by either party after certain minimum time and without penalty.

3. Risk of obsolescence

- In a financial lease the lessee assumes the risks of obsolescence, loss, mechanical or electrical breakdown.
- In an operational lease the risks of obsolescence, breakdown and poor residual value lie with the lessor.

4. Flexibility

- In general, greater flexibility is bestowed on the user in the case of operational leases than financial leases, e.g. if equipment becomes under-utilised it can be returned by the lessee or he can have it replaced by a more suitable item.

5. Responsibility of maintenance

- In a financial lease, insurance, maintenance, repair and other costs related to the use of the leased asset are usually paid by the lessee.
- An operational lease normally includes these provisions within the terms of the lease contract, therefore these are the lessor's responsibility.

6. Providing the asset

- In a financial lease, the lessee is often in control of ordering, delivery and disposal.
- In an operational lease, the lessor generally supplies the asset.

7. Types of assets

- Aircraft, rail cars, and buildings are generally leased through a financial lease.
- An operational lease is widely used for certain types of equipment such as computers, office equipment, motor vehicles, and heavy equipment, where the technological development is rapid.

Other types of leasing arrangements also exist, but they are mostly a variation of either the operational or the financial lease. These have evolved to respond to different demands. They include closed and open-ended leases, percentage leases and master leases. The main sub-classes are classified in the next section.

2.1.3.5 Other forms of leases

Brealey and Myers (1988), Nunnally et al. (1991), and Van Horne (1992), point out that financial leases from the lessor's point of view can be further subdivided into three main types of leases. These are:

- sale and leaseback agreement,
- direct financing lease
- leveraged lease

Sale and leaseback

Sale and leaseback is an arrangement whereby the owner of an equipment enters into an agreement with the leasing company to sell his equipment, approximately at the market value, and under the same agreement, leases it back from the lessor at a predetermined rate for an agreed period. In fact, under this agreement, the equipment or sold assets are not physically exchanged but are a book transaction only. The sale proceeds ease the working capital problems of the lessee, and the same capital may also be used for other development purposes.

Accounting for sale and leaseback transactions reflects the substance of the transaction. The lessee (owner) initially records the transaction as a sale, the lessor (buyer) records it as a purchase, and the lease is accounted separately by both the lessee and the lessor, depending upon whether the leaseback is determined to be a financial or operational lease.

Direct leasing

Under direct leasing, a lessor either owns or acquires the asset and leases it to a lessee who did not own the asset previously. The lessor may be the actual manufacturer of the asset, or may be a financial institution, a bank, or an independent leasing company. For all leasing agreements involving all but manufacturers, the vendor sells the asset to the lessor, who leases it to the lessee.

Leveraged leasing

A leveraged lease is a transaction in which a lessor borrows money and purchases property and then leases that property to a lessee. From the standpoint of the lessee, there is no difference between a leveraged lease and any other type of lease. The lessee contracts to make periodic payments over the basic lease term and is entitled to the use of the asset over that period of time. The primary difference between a leveraged and non-leveraged lease is in the role of the lessor. In a non-leveraged lease the lessor provides 100 % of the capital from his own funds, while in a leverage lease the lessor becomes the owner of equipment by providing only a percentage (20% to 40%) of the necessary capital. The remainder of the capital in a leveraged lease is borrowed from institutional investors, such as banks, insurance companies, trusts, pension funds and foundations. Thus there are at least three parties in a leveraged lease: the lessee, the long-term creditor and the lessor.

Characteristics of a leveraged lease are pointed out by Athanasopoulos and Bacon (1980) as :

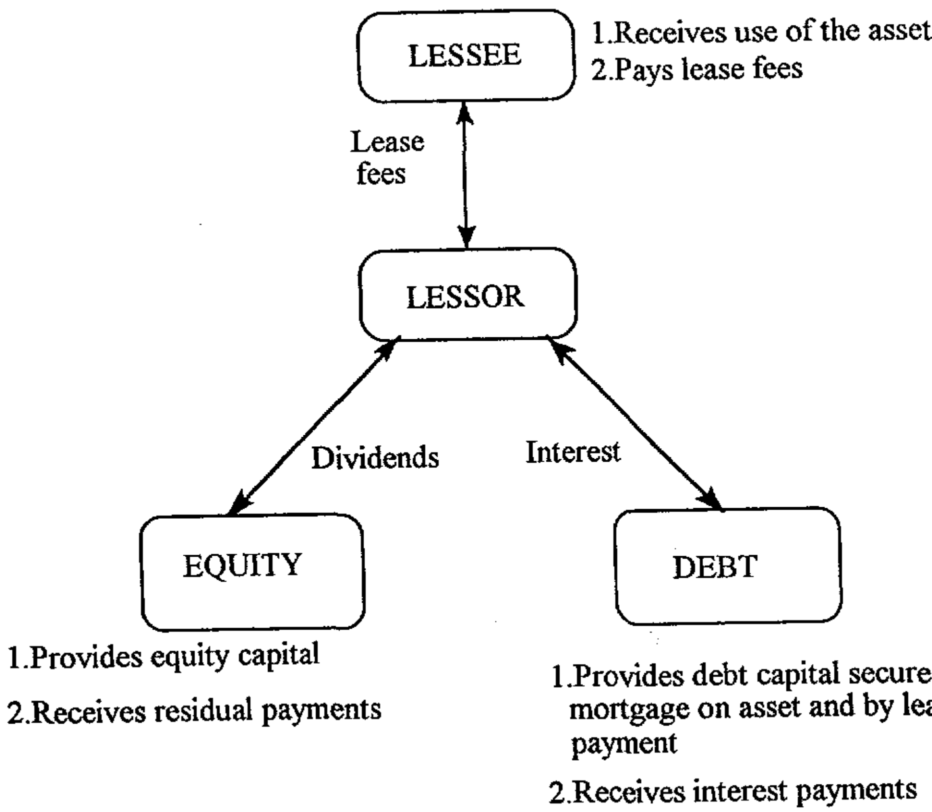
> " A leveraged lease is one in which the lessor borrows a substantial portion of the purchase price of an item of capital equipment on a non-recourse basis. To secure the loan, the lender holds a first mortgage on the equipment.......Rental and other payments go directly to the lender (or a trustee), and interest and principal are deducted. The difference between the debt service due and the lease payment is then sent to the lessor..... The lessor benefits fully, however, from the investment tax credit, depreciation tax shields, and any residual value."

Copeland and Weston (1988, p.628) represent a leveraged lease schematically as in Figure 2.1.2.

Figure 2.1.2

Schematic representation of a leveraged lease

(Copeland and Weston, 1988, p.628)



According to Clark (1978), financial leases can also be subdivided in several ways, such as :

1. *By type of asset:* Any tangible durable asset may be leased. Equipment leasing companies do not generally engage in the leasing of real property–land, industrial buildings, and dwellings, but leases of major

items of industrial plant, such as an oil refinery and general plant and machinery.

2. *By type of facility:* Leasing companies enter into agreements both as a result of direct discussion with lessees and through introductions from equipment manufacturers and distributors' sales-aid facilities. Leases can be directly arranged either for individual items of equipment or as a "shopping basket " covering a number of different items which the lessor and lessee usually identify and agree to lease after a master lease agreement has been executed.

3. *By market:* Leasing agreement can be domestic, with lessor and lessee in the same country, or international leasing which covers two types of activities: cross-border and export leasing. Cross-border leasing describes those leasing arrangements where the lessee and the lessor are domiciled in different countries and includes export leasing.

4. *By tax treatment:* The lessor expects to claim a certain per cent first year capital allowance, for which most items of equipment are eligible, and reflects the benefit in the form of reduced rentals. However, in some cases, either the equipment does not qualify for an allowance or a leasing company is unable to obtain any benefit from it.

Definition, interpretation and practice of leasing is described in the following three sections for the USA, the UK and Turkey.

2.1.3.6 Leasing in the USA

Isom and Amembal (1982) maintain that the answer can be given to the question what a lease is, and what the difference is between an operational lease and financial (capital) lease, from an economic, legal, accounting, financial or industry point of view; the right answer depends upon the needs of the person asking the question. They define lease as follows:

> " In general, a lease is viewed as a contract between a lessor (owner of an asset) and a lessee (user of an asset) where the lessor grants the temporary possession and use less than the asset's economic life at a fixed periodic charge (rental charge)."

The Financial Accounting Financial Board (FASB) statement number 13, on accounting for leases, also divides leases into two basic groups. A lease is either a capital (financial) lease or an operational lease. The statement does not consider that a financial lease is really a true lease, but rather a sale of equipment from the lessor's viewpoint and a purchase from the lessee's. An operational lease is a true lease, both from the lessor's and lessee's viewpoint (see Figure 2.1.3).

According to this statement, if a lease agreement meets one or more of the following four criteria, the lease shall be classified as a financial lease by the lessee. Otherwise, it shall be classified as an operational lease.

1. The lease transfers ownership of the asset to the lessee by the end of the lease term.
2. The lease contains an option to purchase the leased asset at a bargain price.

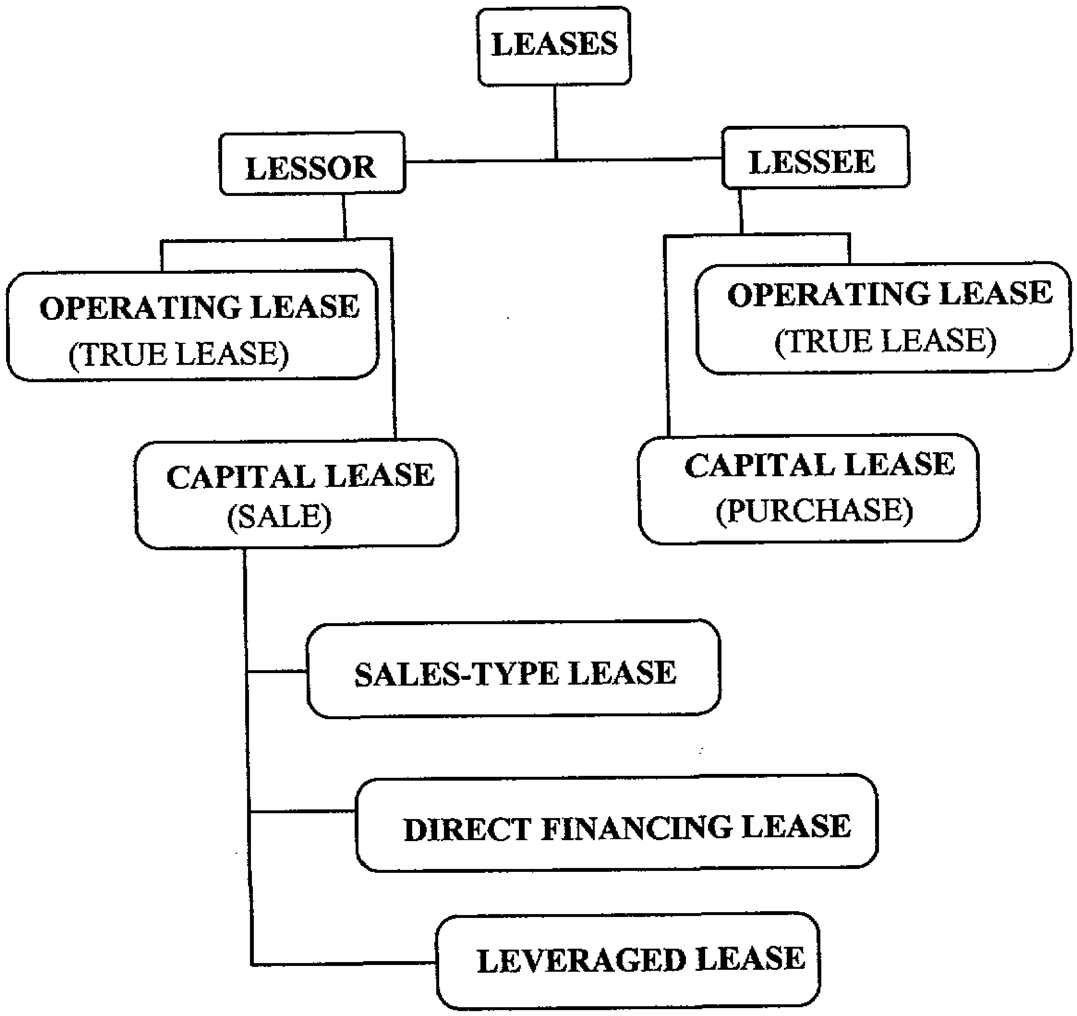
3. The lease term is equal to 75 % or more of the estimated economic life of leased asset.
4. At the beginning of the lease, the present value of rental and other minimum lease payments equals, or exceeds, 90% of the fair market value (FMV) of the leased asset.

Criteria 3 and 4 are not applicable when the beginning of the lease term is within the remaining 25 % of total estimated economic life of the leased property.

For both tax and accounting purposes, the lessees, under the financial lease, transfer ownership of the leased asset and capitalise it since the asset has been purchased. The lessee must also record as an obligation a liability at the same value amount at which the asset was recorded. A leased asset under financial lease is amortised in a manner consistent with the lessee's usual depreciation policy for an owned asset and the liability reduced over the lease period. The amortisation is restricted to the lease term, rather than the life of the asset, unless the lease provides for transfer of title or includes a bargain purchase option.

Figure 2.1.3

Lease types



Source: Isom and Amembal (1982, p.21)

Furthermore, the following information shall be disclosed in the lessee's financial statements or in its footnotes:

1. Total assets recorded as capital leases should be separately identified along with separate identification of the corresponding current and long-term lease payable.

2. Future minimum lease payments.
3. Subleases rentals to be received in the future from non-cancellable subleases.
4. Contingent rentals actually incurred by lessee.
5. Separate identification of accumulated depreciation and current depreciation charges on any capital leases.

If none of the criteria which satisfy financial lease are met, then the lease is considered a true lease by the lessee and is referred to as an operational lease. This type of lease, also known as an IBM lease, maintenance lease, or service lease, includes both financing and maintenance services. Neither an asset nor an obligation is recorded by the lessee for the operational leases. Rental payments are recorded as rental expenses in the income statement. It is concerned with the provision of a complete service to the lessee rather than simply a financial arrangement.

For operational leases, the following information shall be disclosed in the lessee's financial statement or in the footnotes :

1. Future remaining minimum rental payments required as of the date of the latest balance sheet presented, in total, and each of the five succeeding fiscal years.
2. Rental expense for each period for which an income statement is presented, excluding rental payments and sublease rentals.
3. The total of minimum rentals to be received in the future under non-cancellable subleases as of the date of the latest balance sheet presented.

The requirements for capitalising financial leases and for standardising disclosures and general footnote reporting by lessees for both financial and operational leases, from the point of view of "off-balance sheet" financing, are not attractive to the lessees at all.

From the lessor's perspective, a lease is classified as a sales-type, direct financing, leveraged lease and operational. If a lease meets any one of the four classification criteria for financial lease specified above, and in addition, both of the following further criteria, it shall be classified as a sales-type lease or direct financing lease. If none of these criteria are met then the lease is considered an operational lease by the lessor.

1. Collectibility of the minimum lease payments is reasonably predictable. A lessor shall not be precluded from classifying a lease as a sales-type lease or as a direct financing lease simply because the receivable is subject to an estimate of uncollectibility based on experience with groups of similar receivable.
2. No important uncertainties surround the amount of unreimbursable cost yet to be incurred by the lessor under the lease. Important uncertainties might include commitments by the lessor to guarantee performance of the property in a manner more extensive than the typical product warranty or to effectively protect the lessee from obsolescence of the leased property.

A lease meeting these criteria is classified as a sales-type lease if the fair value of the leased asset is different from its carrying amount. Otherwise, unless the lease meets certain additional criteria for leveraged leases, to be given later, a lease meeting one of the first four criteria and both of the last two is classified as a direct financing lease.

Sales-type and direct financial leases

A sales-type lease gives rise to gross profit on the lease in addition to interest included in the lease payments. Sales-type leases normally result when a manufacturing company uses leasing as a means of marketing its products. In a direct financing lease, the asset cost to the lessor and its market value are the same. Therefore, these types of leases do not give rise to any profit, but have interest included in their lease payments.

According to FASB No. 13, if a lease satisfies the criteria above, it effectively transfers the benefits and burdens of ownership to the lessee in the nature of an instalment sale. Therefore, accounting for these types of leases parallels accounting for instalment sales. But there are some specific differences in accounting for them.

In most respects, accounting for sales-type and direct financing is the same. Under both types of lease, the lessor records the gross investment in the lease and unearned interest revenue. Lessors under sales-type leases, however, also recognise a sale. The differences between accounting for direct financing and sales-type leases relates to recording profit or loss.

FASB 13 requires lessors to disclose the following information about sales-type and direct financing leases :

1. The components of the net investment as of the balance sheet date.

2. Future minimum lease payments to be received for each of the five succeeding fiscal years, as of the date of the latest balance sheet presented.

When accounting for a sale and leaseback transaction, the lessor records the transaction as a purchase and a direct financing lease, or a purchase and an operational lease, depending on the terms of the lease back.

Leveraged leasing

Leveraged lease is simply a direct financing lease which is sometimes used in financing assets requiring large capital outlays. This type of lease involves three parties: lessee, lessor and creditor (for more detail see Section 2.1.3.3.1).

According to FASB No. 13, leveraged leases are capital leases that have all of the following additional characteristics :

1. They involve at least three parties: a lessor, a lessee, and a long-term creditor.
2. The financing provided by the long-term creditor is substantial to the transaction and is non-recourse to the lessor.
3. Lessor's net investment declines during the early years of the lease and rises during the later years of the lease.
4. Any investment tax credit retained by the lessor is accounted for as one of the cash flow components of the lease; otherwise, the lease must be considered a direct financing lease not a leveraged lease.

A leveraged lease offers the lessor tax advantages in the USA because the interest charges incurred by the lessor and depreciation deductions on the asset offset part of the revenue generated by the transaction. Lessors account for these leases in the same manner as they account for other direct financing leases, except that the lease receivable is recorded net of the nonrecourse liability (Nunnally, 1991).

From the standpoint of the lessee, leveraged leases are classified and accounted for in the same manner as financial leases.

Operational leases

If a lease is classified as an operational lease by the lessor, the leased asset is capitalised and recorded in the balance sheet. The asset is depreciated following the lessor's normal depreciation policy, and in the balance sheet is to be deducted from the investment in the leased asset. Rent is reported as income over the lease term as it becomes receivable according to the provision of the lease. Initial direct costs of a leased asset are deferred and allocated over the lease term in proportion to the recognition of rental income.

FASB No. 13 requires lessors to disclose the following information about operation leases :

1. The cost of leased property and the amount of accumulated depreciation as of the balance sheet presented.

2. Minimum future rentals on non-cancellable leases, as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding fiscal years.
3. A general description of the leasing agreements.

In the USA, the Internal Revenue Service (IRS) also is concerned whether a lease is a financial lease or an operational lease. In the case of financial lease, the IRS permits the lessee to obtain the tax benefits of investment tax credit, depreciation, and interest included in the lease payments. On the other hand, in the case of an operational lease, the IRS allows the lessor rather than the lessee to retain the investment tax credit and depreciation. Moreover, within an operational lease, the lessee may not claim a separate interest deduction for interest contained in each lease payment since the total lease payment is already fully tax-deductible by the lessee. Therefore, it is essential to know whether a lease is financial or operational in order to ascertain who will receive the tax benefits - the lessee or the lessor.

In addition, the lease term must be less than 30 years, otherwise the transaction will be regarded as a purchase of an asset.

2.1.3.7 Leasing in the UK

One of the best known definitions of leasing in the UK is that adopted by the Equipment Leasing Association of England (ELA) (Clark, 1978):

> " A lease is a contract between a lessor and lessee for the hire of a specific asset selected from a manufacturer or vendor of such assets by the lessee. The lessor retains ownership of the asset. The lessee

has possession and use of the asset on payment of specified rentals over a period."

The lease does not normally in the UK confer on the lessee either the right or the obligation to acquire the asset during the lease term or thereafter. With buy and borrow, both the asset and associated debt appear on the balance sheet. A lease, however, is off-balance-sheet finance and neither asset nor liability appear.

There are two basic types of lease contract in the UK: financial lease contract and operational lease contract.

According to Grant and Gent (1992) the Statement of Standard Accounting Practice 21–Accounting for Lease and Hire Purchase Contract (SSAP 21) distinguishes between two types of lease contract as follows :

1. Finance leases which confer substantially all the risks and rewards of ownership of the asset to the lessee.
2. Operation leases comprising all other leases.

Financial lease

SSAP 21 defines a financial lease contract as:

> "A lease that transfers substantially all the risks and rewards of ownership of the asset to the lessee."

From the SSAP 21 definition it is very difficult to classify lease contracts, because all lease contracts transfer some of the risk and reward of ownership. The main difficulty lies in determining the proportion of risk, which is defined *substantially*, and reward which has been transferred.

The definition of financial lease by ELA is as follows (Clark, 1978, p. 58):

1. The equipment is chosen from a manufacturer or a distributor of such equipment by the lessee, not the lessor.
2. The lessor retains ownership of equipment. It is fundamental to the concept of leasing in the UK that a lessee should have no right or opportunity at the time of setting-up the leasing facility to acquire title to the equipment at some future date.
3. Subject to the payment of rent and compliance with the other terms of the lease, the lessee has the exclusive right to use the equipment during the whole period of the lease.
4. There is a non-cancellable section of the lease period during which the leasing company seeks to recover the whole, or a major part, of its capital outlay together with its outgoings and the profit margin.
5. The burden of obsolescence of the equipment falls primarily on the lessee.

Hubbard (1980) illustrates that a financial lease contract is a lease which has the following characteristics:

1. Contract covers the major part of the asset's economic life;
2. Non-cancellable , or cancellable with major penalty;
3. The lessor expects to gain his normal profit on the asset without being involved in further activity;

4. The lessee is responsible for repairs, maintenance and insurance;
5. The risk of obsolescence lies with the lessee;
6. The lessor does not need to be technically knowledgeable about the leased asset.

The financial lease should be recorded on the balance sheet of lessee as an asset and obligation to pay future rents. The leased asset should be depreciated over either the term of the lease or the useful life of the asset, whichever is shorter. Obligation under a financial lease should be disclosed separately from the other obligations and liabilities, either in the balance sheet or in the notes to the account.

The leased asset should not be capitalised on the balance sheet of the lessor and consequently there is no provision for depreciation. The amount from the lessee under a financial lease should be recorded on the lessor's balance sheet as receivable. Also, the lessor in a financial lease should disclose the following at each balance sheet date:

1. The policy adopted for accounting for a financial lease and, in detail, the policy for accounting for financial lease income.
2. Aggregate financial lease rents receivable in respect of an accounting period.
3. The cost of asset required, whether by purchase or by financial lease, for the purpose of leasing under financial lease.

For taxation purposes leases do not need to be distinguished, because both financial and operational leases are treated in the same way. The lessor, who is the legal owner of the leased asset, is entitled to the capital allowances. Rents are fully taxable as income for the lessor. For the lessee they are fully tax-deductible.

Operational lease

SSAP 21 defines an operational lease contract as any lease contract that is not a financial lease. In an operational lease , the lessee does not have a purchase option on the leased asset.

According to Hubbard (1980), an operational lease is a lease in which

1. The lessee can cancel at short notice without major penalty.
2. The lessor expects to re-lease or sell the asset.
3. The lease term is shorter than the leased asset's economic life.

Under an operational lease contract, the leased asset should be recorded as a fixed asset and depreciated over its useful life by the lessor. The rents received under the operational lease, excluding charges for services such as insurance and maintenance, should be recognised as income and are fully taxable. The following information should be disclosed in the lessor's balance sheet (Leaseurope and Arthur Andersen, 1992):

1. The gross amount of assets held under operational leases and the related accumulated depreciation charge.
2. The policy adopted for accounting for operational leases.
3. The aggregate operational lease rents receivable in respect of an accounting period.

The leased asset is not capitalised in the accounts of the lessee and consequently there is no provision for depreciation. The rental payments are fully tax-deductible. The total operational lease rental charged as expenses in the profit and loss account has to be disclosed and broken down into the amount payable in respect of the hire of plant and machinery, and the amount payable in respect of other assets. The total future rental payments also have to be disclosed in the lessee's balance sheet as follows:

1. Amounts payable within 1 year.
2. Amounts payable between year 2 and year 5.
3. Amount payable thereafter.

All companies incorporated in the UK are UK residents for taxation purposes and are subject to taxation on their world-wide profit. The rate of taxation is currently 33 %, however a lower rate of 25 % is allowable if the profits of the company do not exceed £250,000 for the financial years ending 31 March 1992 onwards.

VAT legislation does not distinguish between financial and operational leases. The VAT rate of 17.5 % is applicable on all rents if the leased asset is subject to VAT.

Hire purchase agreement

The other type of use of an asset without actually purchasing practised in the UK is hire purchase. Although it not considered as a lease contract, there is some similarity.

A hire purchase agreement is an agreement where the hirer has a special purchase option to buy the hired asset. The exercise price of the option may either be a specified amount or it may be included as part of a series of instalment payments. The hirer must have the right to terminate the agreement at any time prior to the payment of the last instalment. Otherwise, the option to buy becomes an obligation and the agreement becomes a conditional sale. In a hire purchase agreement the ownership of the assets passes to the hirer who is therefore entitled to capital allowances.

According to Aydon (1972), the essence of a hire purchase contract, as compared with a leasing agreement, is :

- A large part (sometimes all) of the capital cost is treated as a loan, bearing a stated rate of interest.
- The hirer has the right to acquire the property for a nominal sum on completion of the repayments.

Myers and Nicholas (1988) say the distinction between a lease contract and a hire purchase contract is very important because of the different benefits of capital allowances. And they define a hire purchase contract as :

> " A type of lease under which the lessee has the obligation, or option, to purchase the asset at the end of the term usually for a nominal consideration. The lessee, and not the other financier, will generally be able to claim capital allowances in respect to the asset."

In general, the following differences emerge between lease agreement and hire purchase:

1. Leasing is used mainly in the field of industrial finance while hire purchase is used mainly in the field of personal finance.
2. Hirers are protected against repossession in a hire purchase contract, but there is no such protection available to lessees.
3. No deposit is payable in a leasing contract and instalments are payable in advance, but there is a substantial deposit usually payable immediately in hire purchase, while instalments are normally paid in arrears.
4. Ownership of the asset in a hire purchase contract eventually passes to the hirer, but at no stage can ownership pass to the lessee in a leasing contract.
5. The average value of items purchased under hire purchase is generally much smaller than under a leasing contract.

Hire purchase agreements that are of a financing nature should be accounted for on a basis similar to that set out for financial leases described earlier.

2.1.3.8 Leasing in Turkey

In Turkey there are general restrictions on the right to lease; in other words, lessors whose companies which are established as a *'financial rental company'* and financial institutions empowered by the law, such as private financial institutions and development and investment banks, have a right to lease. But there is no limitation placed on either lessee or leased asset. Anyone, companies and individuals, can lease any type of movable or fixed assets.

The Turkish Financial Leasing Law (Number 3226) does not actually define what leasing is, but does lay down regulations regarding leasing companies, rental contracts, incentives, taxation and funding structure.

As already seen in the first section of this chapter (2.3.1) the leases are divided into two basic groups, namely financial lease and operational lease. According to the regulations of the Turkish Financial Leasing Law and practices there is no distinction between financial and operational leases. All lease agreements contracted by ' *rental leasing companies*' and empowered financial institutions in Turkey are accepted as lease agreements, regardless of any distinction. Their characteristics are in part compatible with the definitions of financial leasing, operational leasing and hire purchase which are being practised in the USA and the UK.

All leasing agreements in Turkey are regarded as 'financial rental', and this should be understood as financial leasing.

Turkish leasing practice requires

1. Lease term should be a minimum non-cancellable period of four years (though with some exceptions, see Section 2.2.6.3).
2. Lease agreements give the lessee an option to purchase the leased asset at the end of the lease period at a specified price.
3. Lessees are obliged to bear service, maintenance cost of the leased asset, and insurance premiums.
4. Incentives granted to the lessee, for plant and equipment, are transferable to the lessor.
5. The ownership of the assets remains with the lessor until the end of the lease period.

6. Lessee is the economic owner of the asset during the lease term and is expected to derive economic benefit from its usage.
7. Lessee cannot transfer possession rights to any third party in any way.

At present in Turkey there are no commonly accepted accounting standards used by both lessors and lessees in leasing transactions. Financial leasing companies keep their accounts according to Turkish Tax Procedural Law. Leased assets are capitalised and recorded by the lessors as fixed assets subject to predetermined depreciation covers over the economic life of the assets. All rental payments received by lessors are recognised as income and are taxable as such. The leased asset can not be capitalised on the balance sheet of the lessee and therefore cannot be depreciated, either. All rental payments made by lessees are fully tax-deductible.

All companies in Turkey at present are subject to 25 % corporation tax rate. Currently, leasing companies are required to charge 1% VAT on all items to be leased, with the exception of trucks and commercial vehicles where the VAT rate is 8%, and cars, which have a 23% VAT rating.

2.1.3.9 Differences between lease and rental agreements

The major difference between leasing and rental is that leasing is largely a financial transaction while rental can be recorded as the provision of a service. An operational lease in some cases can be regarded as a service transaction. In general, the following theoretical differences emerge between the two :

1. *Length of contract:* Leasing is generally in excess of one year, while rental can be for one year or less.

2. *Maintenance:* In leasing, the lessee is responsible for maintenance, except in the case of some operating leases, but in a rental contract the owner is responsible for maintenance.

3. *Choice of goods:* The lessee selects the equipment he wishes to lease, whereas rent provides equipment from stock held by the owner.

4. *Replacement:* A rental agreement provides a replacement if the original equipment breaks down or is irreparable.

The above differences are purely theoretical; in practice, leasing and rental contracts overlap considerably, especially in the case of motor vehicles. Also, where expensive equipment is leased, the lessor will ensure that the equipment is properly maintained by arranging for a maintenance contract.

As a result , leasing is understood in different ways in different countries. For example, hire purchase as practised in the UK is considered as financial leasing in Spain, Turkey and Singapore. In France, no distinction exists between operational and financial leasing. A fundamental distinction does however exist between the leasing of equipment without the lessee having an option to buy (location simple) and the leasing of business equipment with a purchase option (crédit-bail) (Dore, 1992B). Nearly all leasing transactions in Spain are finance leasing. In the definition of leasing in

Spain, the *arrendamiento financiero*, the contract must give the lessee a purchase option on the leased assets, executable at the end of the lease period. If the lessee does not exercise the option, the lessor may lease the asset to another lessee but, in this case, the leased asset needs to be to the specification of the second lessee (Dore, 1992a).

These different definitions come under a general heading of instalment credit for a wide range of equipment, from office machinery to oil refineries and aircraft. The practice of leasing implies special consideration being given to legal questions, accounting methods, and in many countries to taxation.

Within all definitions of leases every lease involves at least two parties. The user of an asset, the lessee, and the owner of an asset, the lessor.

2.1.3.10 Lessee

Lessees are those individuals, companies, corporations and institutions which lease assets, equipment, from a leasing company for a predetermined lease rental, under the contract of lease. The lessees range from industrial corporations, transport companies and service businesses to all kinds of governmental bodies. The common factor is that they pay lease rentals at regular intervals in advance, monthly, quarterly, half-yearly or annually. In many cases there will be no initial deposit. At the end of the period of the lease contract it is possible in some countries to buy the asset outright for a nominal price; sometimes, the lessee has a legal right to do so; in other countries, such as the UK, the lessee has no right to do so, otherwise it is considered a hire purchase rather than a lease agreement.

The general characteristics of lessees may be described as follows :

a) The lessee may select the asset from a manufacturer or a dealer.
b) The lessee makes specified payments for an obligatory period on the leased asset to the lessor.
c) The lessee has exclusive use of the leased asset over the lease period.

2.1.3.11 Lessor

Lessors are those individuals, companies, partnership, corporations and financial institutions which lease assets, equipment, to the lessee, under a contract of lease at predetermined lease rentals. The lessor is generally a bank or a finance house, and usually the leasing business is conducted through a subsidiary. However, there are a large number of independent leasing companies in the US, Europe and Japan. The other categories of leasing companies are subsidiaries of business corporations, which invest in assets for leasing to non - connected parties, and manufacturers, who want to sell their product through leasing.

2.1.4 FINANCIAL CONSIDERATIONS IN LEASING DECISIONS

Since leasing is often seen as an alternative form of finance, in practice any item can be leased and can also be bought; thus there is a decision to be made as to whether to buy or to lease.

In this section, leasing evaluation methodology and techniques are examined.

In the literature much attention is given to attempts to resolve the following issues:

1. Whether a leasing decision is an investment or a financial decision.
2. To what degree leasing displaces debt.
3. What discounted rate should be used in assessing the leasing decision.

2.1.4.1 Investment or financial decision

A review of the published literature to date indicates that there is much disagreement among academics as to whether the decision to lease is an investment decision or a financial decision.

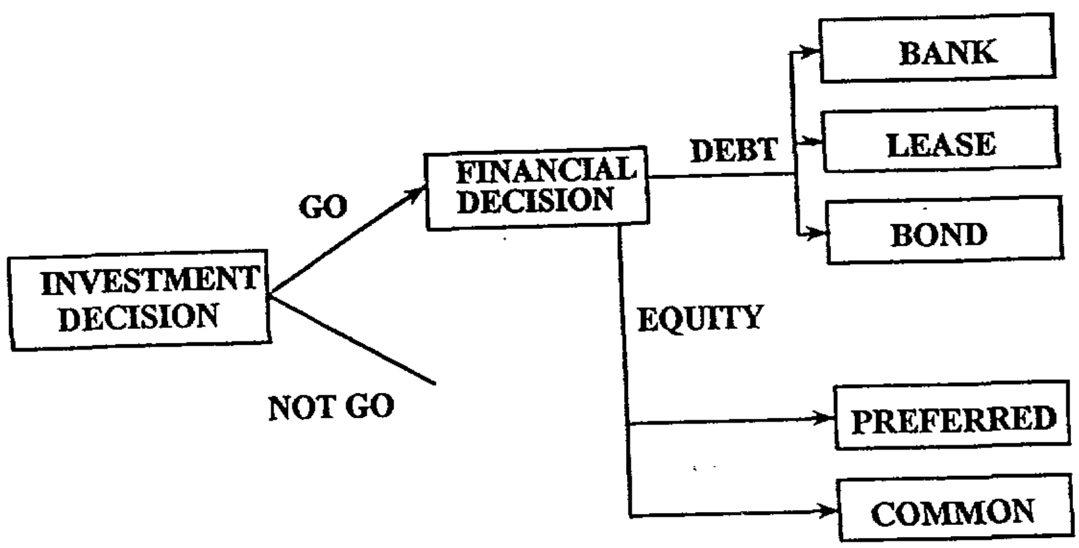
Generally, in decisions about capital expenditure, the decision to acquire is the major decision to be made. After the acquisition decision has been made, the decision to choose a method of finance for the particular acquisition can be considered. It is at this point that the question of lease finance or other method of finance is considered.

Vancil (1961) observes that "buying a piece of equipment and acquiring it under an operation lease is essentially an investment decision, but the choice between buying a piece of equipment and acquiring it under a financial lease is a financial decision rather than an investment decision."

Ferrara, Thies and Dirsmith (1980) give a diagram in support of their position that leasing is a form of financing (see Figure 2.1.4).

Figure 2.1.4

Investment or financial decision



Source:Ferrara, Thies and Dirsmith (1980)

The figure illustrates two important facts. The first is that the investment decision precedes and is distinct from the financial decision; the second one is that leasing is a form of debt.

Sykes (1976), Hubbard (1980), and Van Horne (1983) supported this view that there are two separate decisions, and leasing is solely a financial decision to be made subsequent to the investment decision. Pike and Dobbins (1986) express the same view that the leasing decision is only a financial decision, not an investment decision. Once a firm has decided to invest in an asset, a second decision should be made as to the most appropriate method of financing.

On the other hand, Johnson and Lewellen (1972) believed that leasing is a pure investment decision, since the lease is a long-term acquisition of a service contract which is different in timing, but not in the impact of financing, from a purchase.

In this debate, Beechy (1969), Ofer (1976), and McConnell and Schallheim (1983) state that leasing is partly a method of investment and partly a method of financing decision, in the sense that the lessor is supplying both use of the asset as well as the funds to acquire the asset, and is charging for both. Nunnally et al. (1991) support this view (see Figure 2.1.4) that leasing combines certain aspects of investment and financial decisions.

Bower (1973) and Clark (1978) both agree that by approaching this question in view of the emphasis, the " lease versus buy " decision is a combining of an investment and financing decision, but when the " lease versus borrowing " decision is considered it is a purely financial decision.

Franks and Broyles (1979) maintained that leasing may be a financing decision contingent on the investment decision. Such an analysis must satisfy two conditions :

1. The Net Present Value (NPV) of the lease must be positive.
2. The sum of the NPV of the project as an investment (without the lease) and the NPV of the lease must be positive.

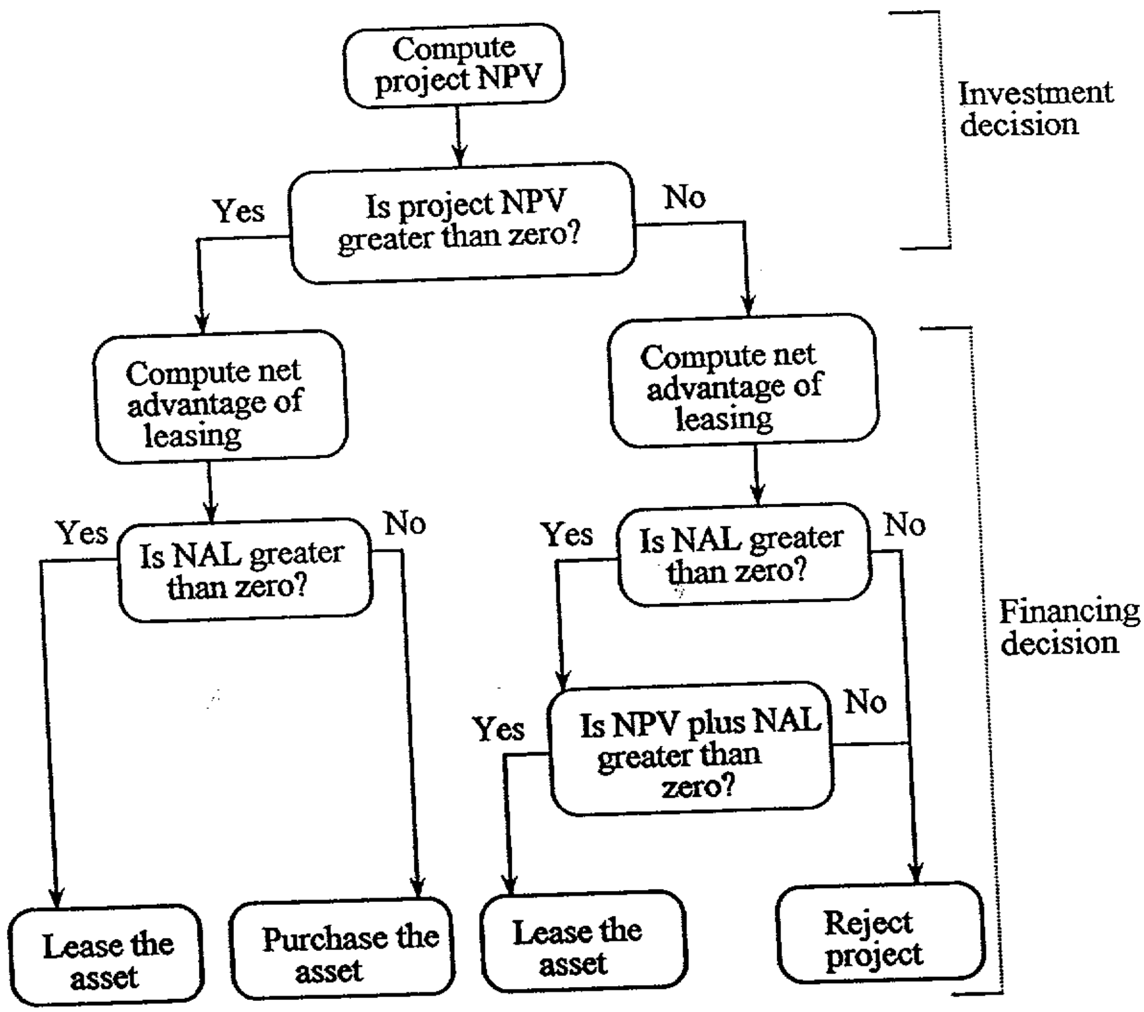
In practice, managers may face different situations; if the management has determined that the project is mandatory, the only decision is how the project is to be financed, whether by purchase or by leasing. Leasing analysis is thus essentially a financing decision.

Furthermore, Schall (1974) and Fawthrop and Terry (1976) argued that it should be an integrated investment and lease-financing decision, as opposed to a purely financial decision. This was because until the financial decision is made, an appropriate capital allowance can not be ascribed to the investment project. The use of capital balances (the differences between initial asset cost and lease instalments paid) leads to the secondary investment. For a proper measurement of the effect, there has to be an integration of the financing decision and the secondary investment decision. Additionally, until the amount of capital to be raised is known, an appraisal rate for discounted cash flow can not be determined, and without this information it is not possible to evaluate alternative forms of finance.

Figure 2.1.5

Evaluating the leasing alternative

(Nunnally et al. 1991, p.136-137)



NAL: Net Advantage of Leasing

NPV: Net Present Value

2.1.4.2 Leasing and debt displacement

Another disagreement among the writers about leasing is the debt displacement issue which arises in the lease or purchase decision, because an owned asset generates borrowing or debt capacity, whereas a leased asset does not.

A large body of literature on finance suggests that leases and debts should be perfect substitutes; an increase in one should lead to a compensatory decrease in the other.

According to Ang and Peterson (1984), there are three views on debt displacement by lease:

1. Cash flow from lease obligations as equivalent to debt cash flow, thus describing the trade-off between debt and leases as one-to-one.
2. A trade-off of lease for debt is less than, but close to one.
3. A trade-off of lease is greater than one-to-one, that is, a dollar of lease obligation uses more debt capacity than a dollar of debt capacity.

On the argument as to whether leasing displaces debt on a one-to-one basis, surveys found that practice was different.

The study of Fawthrop and Terry (1976), in their survey in the UK, indicates that leasing was often used as an emergency or last-resort means of financing, implying the existence of what they called a " spill-over financing" strategy.

Sykes' (1976) survey, which covers 202 users of leasing companies in the UK, found that over two-thirds of all respondents acknowledge the fact that leasing was a source of funds which did not utilise existing working capital.

According to Clark (1978), the following factors can be relevant to increase a firm's debt capacity :

1. Imperfect knowledge on the part of lenders.
2. Leasing is less risky for a financial institution than debt secured on the leased asset, for it is generally cheaper and easier to repossess the asset in the event of lessee default.
3. The lessor has a share in the residual value of the asset.
4. The lessor may be liable to some third party claims for losses arising out of the use of the equipment.

Empirical research in the USA has been interpreted in radically different ways by researchers. Surveys using financial statement data have been unable to verify that leases and debt are substitutes for each other. Neither Sorensen and Johnson (1977) nor McGugan and Caves (1974) were able to come to any definitive conclusion regarding substitution of debt. Crawford et al.(1981) analysed fifty pure financial leases in Houston over the period 1973 to 1980 and found again contradictions in the compatibility of lease and debt.

Ang and Peterson (1984) surveyed approximately 600 firms. Again, their results were inconclusive as to the degree of debt substituting. Instead, the results indicated that leases and debts were complements: greater debt was associated with greater leasing. This evidence was in sharp contrast to the survey results of Bayless and Diltz (1976); the results, based on 133 responses, show that bank loan officers reduce their willingness to lend when a firm takes on lease obligations. The results also indicated that a capital lease displaced approximately 10 to 26 % more unused debt capacity than does debt financing.

On the other hand, the results of the study of Marston and Harris (1988), who surveyed a large sample of US firms, clearly shows that leases and non-leasing debt are substitutes, increases in leasing being typically accompanied by reductions in the use of debt.

Myers et al.(1976) attempt to evaluate exactly how much debt is displaced and to calculate the implicit loss in firm value due to the loss of the tax shield from borrowing. They analysed the lessee's valuation of a lease contract by comparing the value of two transactions :

1. [Leasing] " Purchase the necessary cash by giving up the asset's depreciation tax shield, salvage value and investment tax credit, and by agreeing to make a stream of cash payments to the lessor."
2. [Purchase & finance] "Purchase the necessary cash by selling whatever package of financing instruments is optimal when leasing is excluded."

In conclusion, they suggest that a dollar of lease liability supports or displaces a dollar of debt (one-to-one) but this is not obvious from their arguments.

Nunnally et al.(1991) maintain that leasing appears to displace a greater quantity of debt capacity on the lessee's balance sheet than it provides :

"Leasing and debt may look similar to one another, but they are not completely alike. In particular, lessees lose the tax shields provided by the depreciation and interest expense. Because these tax shields have value to firms reporting taxable income, the lease displaces somewhat more financing capacity than it provides. In addition, lease payments represent a liability senior to the claim of debt holders, which reduces the value of existing debt within firms that lease a significant portion of their capital assets. This means that the cost of debt for these firms increases so that a given principal balance requires larger debt-service payments. Together, these important differences between leasing and borrowing explain why a single dollar's lease obligation displaces about $1.25 in excess borrowing capacity.

Idol (1980) maintains, as Myers et al.(1976) suggested, that it is possible that the firm's debt service capacity displaced by lease payment (one-to-one basis) should be equal to one, given the similar effect on the firm's debt services capacity of both financial lease and loan obligation.

However, many other studies suggest that debts and leases are close substitutes; these different opinions and experiences indeed suggest a far more unified approach to deal with leasing problems is required.

2.1.4.3 Discounted rate

The financial literature offers several different discount rate choices for valuing lease cash flow. Bierman (1982), and Nunnally et al.(1991) point out that there are three basic choices for the rate of discount to be used. These are :

1. The after-tax borrowing rate.

2. The before-tax borrowing rate.
3. Some type of risk-adjusted rate, such as the weighted average cost of capital.

If one assumes that there are four possible sets of cash flows and three possible discount rates, there are twelve different ways of combining the two elements. Therefore, one can see why there is no universal agreement on policy regarding the buy-versus-lease decision.

Choosing the appropriate discount rate is one of the most difficult aspects of discounted cash flow (DCF). The main areas of difficulty, as pointed out by Clark (1978), are as follows :

1. ***Equivalent amount of borrowing***: The borrowing profile equivalent to the leasing cash flow is irregular because of the impact of tax relief on the payment.
2. ***Equivalent borrowing cost***: The marginal cost of the equivalent borrowing is not necessarily the same for each year of the lease.
3. ***Frequency of interest payment***: The annual borrowing cost will depend on the frequency of interest payments
4. ***Overall cash surplus***: In some cases, a firm will be deciding not between leasing and borrowing but on using leasing and its surplus cash. In this circumstance, the appropriate discount rate is the earning opportunity rate for the surplus funds and not the marginal cost of borrowing.
5. ***Tax position***: When estimating the cost of borrowing, an adjustment may have to be made for tax relief on interest payment.

Vancil (1961) and Bower et al.(1966) consider using weighted average cost capital (WACC). Copeland and Weston (1988) have also proposed that the WACC be used for the rate of discount.

Van Horne (1992) maintains that "the decision to lease or borrow can be made on the basis of which alternative has the lowest present value of cash flow outflows or the lowest after-tax internal rate of return."

Brealey and Myers (1988) also prefer an after-tax discount rate to value the incremental cash flow stemming from the lease. Like Brealey and Myers (1988) and Van Horne (1992), most writers, notably Mitchel (1970), Myers et al. (1976), Long (1977), Franks and Hodges (1978), and Hull and Hubbard (1980), favoured the use of the after-tax borrowing rate.

On the other hand, Beechy (1969, 1970) prefers to use a before-tax rate for the marginal cost of borrowing.

2.1.4.4 Why a firm leases

There are many reasons why a company may choose a lease rather than purchase an asset. The relative importance of the reasons that enter into a lease decision vary from company to company and for each type of asset leased.

Leasing presents a range of advantages to the firm and it might be expected that the reasons why firms use leasing will tend to vary widely, depending on the particular conditions experienced by the individual firm when the decision to lease is made.

Various advantages have been attributed to leasing by lessors, by lessees, and by financial analysts.

Bower et al. (1966) classify leasing advantages into three main groups as follows :

1. Advantages pertaining to basic cash flows, which can be called *operating advantages*.
2. Advantages pertaining to the uncertainties in basic cash flows, which can be called *risk advantages*.
3. Advantages pertaining to prior claims on the basic cash flows, which can be called *financial advantages*.

Vancil and Anthony (1959) made an early attempt to study why firms lease equipment and used direct-mail surveys to question financial officers about their reasons for entering into lease contracts. Anderson and Martin (1977), and Tomkins et al. (1979) used a similar research method in subsequent studies. The following were the main reasons for firms' preference for leasing over buying :

1. Tax consideration.
2. Shifting the risk of equipment obsolescence and problems of asset disposal to the lessor.
3. Freeing working capital for other uses and preserving credit capacity.
4. Off-balance sheet financing.

The study of McGugan and Caves (1974) identified the influencing factors of the leasing decision as follows :

- Tax deductibility
- Cheapness
- Expected incentive use of asset
- Conserve smooth cash flow
- Maintenance in the package

Huu and Hiang (1987) concluded , in their survey of the Singapore leasing industry, that the factors influencing lessees could be ranked in order of importance as follows :

- Present cash flow
- Future cash flow
- Cost of asset
- Lease rates vs. interest rates
- Tax deductibility
- Life of asset
- Depreciation cost of asset
- Anticipated future profits
- Percentage of financing
- Present profit level

Generally, the advantages of leasing are attributed, by Allen (1967), Van Horne (1971), Aydon (1972), Pierce (1975), Sykes (1976), Wainman and Brown (1978), Clark (1978), Tomkins at al (1979), Craig (1979), Mayes and Nicholas (1988) and Nunnally at al (1991), to the following:

1. ***Conserves working capital***: Leasing provides another source of finance to industrial and commercial companies. By leasing, the use of equipment is obtained without any capital outlay. Therefore existing capital is often conserved through leasing. Delivery and

installation charges can often go into future lease payments and this also conserves working capital.

2. ***Increased debt capacity***: As an additional source of finance, leasing may allow a firm to increase its debt capacity.

3. ***100 per cent financing***: Other forms of debt finance require either a margin of security in favour of the lender or a compensation balance on bank finance. The debtor can normally receive only about 80-90% of the asset's purchase price. However, in leasing, the lessor has responsibility for the full cost of purchase of the asset, though this may not be true if advance rental payment is made.

4. ***Off-balance sheet financing***: Certain types of leases are not capitalised on the balance sheet as lessee's assets and liabilities, although their effect may be essentially similar to debt. (In the USA and the UK, for instance, there is no requirement for an operational lease to be capitalised in the lessee's balance sheet). Therefore, these leases do not raise the debt equity nor hinder the borrowing capacity of the firm. Being able to do this obscures what some observers consider a debt-equivalent arrangement which may be one of the reasons in the firm's decision to lease property.

5. ***Tax advantages***: The deductibility of the entire leasing cost is often cited as a tax-based reason for leasing. Taxpaying lessees obtain compensation through tax savings, but in other forms of finance only the interest on the payment is tax allowable.

6. *Cheap source of finance*: By claiming the available capital allowance the lessor can thus offer the lessee lease payments at lower than market rates. This can obviously be attractive to those who are unable to use full allowances immediately. Leasing also permits payment of the sales taxes to be postponed because these taxes are charged as a percentage of each future lease payment. In the case of small companies, leasing companies as a financial institution (because they have more bargaining power than small companies) may buy an asset at cheaper cost than a small company, so it will be attractive for small companies.

7. *Flexibility*: Leasing offers certain valuable flexibility not available from other sources of finance, such as the acquisition of assets in a form or quantity to suit the lessee's situation. Flexibility advantages of a lease may include such factors as :

   - *Flexibility of rental payment.* The rental payment may be structured according to the revenue expectations of the lessees and arrangements may be made to suit the lessee's cash flow situation.

   - *Flexibility in the choice of equipment.* A single lessor may offer a lease agreement covering several alternative lines of equipment. The lessee selects the equipment of his choice from a supplier and terms can be adjusted to take account of the lessee's payment ability.

- *Flexibility in operation.* Especially, permitting a quick build-up of productive capacity to meet increased demand or a quick shift from one type of equipment to another.

8. ***Hedge against inflation.*** The lessee enjoys immediate use of the asset financed by fixed rental payments which are budgeted on future earnings. Thus, a lessee can make unanticipated substantial gains in periods of rapidly rising inflation. Generally, it is always better to borrow long in a period of inflation, on the assumption that one's revenue sources are also going to inflate in a corresponding way. Leasing as a method of long-term finance is, of course, an effective way of borrowing long. An increase in the price level will affect the cost of money, the value of asset at the end of its economic life and the cost of the asset. The level of inflation must therefore be considered carefully.

9. ***Technological obsolescence.*** A further advantage of leasing the provision of a service by the lessor is the ability of the lessee to have the option of the most modern equipment without either problems of disposal or risk of obsolescence. If rapid obsolescence can be forecast for a leased asset, a leasing agreement with an option to cancel or with an early termination option passes this risk from the lessee to the lessor. This is especially true in the case of an operational lease. Computers and office equipment are frequently leased on a short-term cancellable basis, because it is difficult to estimate how rapidly such equipment will become obsolescent.

10. ***Service and maintenance.*** Particularly in operational leasing, leases include both service and maintenance agreements. These leases

normally call for the lessor to maintain and service the leased equipment, and such cost is built into the lease payment. Computers and office copying machines, together with automobiles and lorries, are the primary types of assets for this sort of leasing contract arrangement.

11. ***Time saving with budgeting and planning***. Financial managers and supervisors generally spend a lot of their time and effort in budgeting and planning. Leasing as a fixed form of agreement with specified rental payments may ease administration and also permits accurate budget planning and forecasting of cash requirements.

12. ***Long-term finance***. A lessor generally offers longer terms than those offered by a financial institution.

13. ***Certainty***. The fixed, non-cancellable nature of a leasing contract makes certain that prearranged conditions will be met by the lessor as well as the lessee. A lease agreement is a medium-term facility; unlike a loan repayable on demand, it cannot be withdrawn or curtailed if there is a credit squeeze or a change in economic conditions. Unless there is default by the lessee, the lessor can not seek accelerated payment of rentals during the primary lease period.

Each of these advantages may to varying degrees have an effect on the investment behaviour of firms. The decision to invest in or finance a project is likely to be influenced by a range of internal and external factors relating not only to past and present conditions but also to expectations of the future.

2.1.4.5 Reasons for not leasing

Commonly cited disadvantages of leasing, by Allen (1967), Van Horne (1971), Aydon (1972), Pierce (1975), Gitman (1976), Sykes (1976), Clark (1978), Tomkins at al (1979), Brealey and Myers (1988) and Nunnally at al (1991), are as follows :

1. ***Residual value***. At the end of the life of the lease agreement the residual value of the lease asset, if any, is realised by the lessor. The loss of residual value may be a serious disadvantage to the lessee. If the assets are expected to appreciate over the life of the lease agreement or the residual value is much higher than expected it may be wiser to purchase them. Other factors such as technical features of the asset and the inflation rate should also be considered in making this decision.

2. ***Prestige or psychological reasons***. Some firms wish to own an asset for psychological reasons, prestige, or as security for collateral for future financing. The purchase of an equipment avoids any restriction applied in the leasing agreement concerning the operation of equipment. Ownership also allows for early disposal of the equipment if the owners want to use it for only a short period of time to raise funds or for the purpose of replacement. But this may sometimes become a disadvantage when the decision for the replacement of outdated equipment is delayed.

3. ***High cost***. Lessors may borrow in order to support their leasing finance. Therefore a lease does not have an explicit interest rate;

rather, the lessor builds a return for himself into the lease payment. In many leases the return interest rates charged to lessees are significantly higher than their own existing channels of funding. Leasing may then be considered a high-cost method of financing by many potential and actual lessees. According to Ferrara, Thies and Dirsmith (1980) leasing may be more expensive than borrowing because of the following reasons:

- Need for the equipment is temporary
- Risk of obsolescence is great
- Maintenance, service and administrative costs are uneconomic
- Equipment is experimental
- Equipment is not available for direct purchase.

The lessor assumes the risk of obsolescence and therefore builds this into the cost of the lease payment, as well as service and maintenance charges. Purchase, therefore, can cost less than leasing.

4. ***Obsolescence consideration***. With a leasing agreement there are a fixed obligations that make early termination of the lease contract impossible without a penalty. If a lessee leases an asset that subsequently becomes obsolete, the lessee generally still has to make lease payments over the life of the lease agreement, even if he is unable to use the leased asset. This is especially true in the case of a financial lease agreement. This type of situation can make purchase preferable to lease.

As a result, there are many reasons why a company chooses or does not choose to lease rather than to purchase an asset. The relative importance of reasons that enter into the leasing decision change from company to company, country to country, because of different economic environments, taxation, legislation , availability, the type of the asset leased, and many other financial and non-financial factors. Therefore every lessee needs to examine and measure each of the advantages and disadvantages of a lease on an individual basis before determining whether to enter a lease agreement.

2.1.4.6 What can be leased

Leasing covers the whole range of capital equipment used by industry and commercial firms from office equipment to oil refining plant. From the lessor's point of view almost any fixed and movable , tangible, durable asset may be leased. This does not of course mean that they are equally suitable.

Myers and Nicholas (1988) in their survey found that the following general characteristic were considered by a lessor as desirable in an asset to be leased:

- non-specialised,
- identifiable,
- mobile/portable/de-mountable/not attached to a building/easy to repossess,
- non-consumable/maintain a residual value/have a ready market/have a useful life in excess of the lease period.

On the other hand, Myers and Nicholas (1988) again point out that lessors indicate that they avoid:

- equipment to which the legal title may be in doubt (e.g. fixtures and fittings attached to a building),
- equipment on which capital allowances may not be claimed,
- equipment which is specialised or depreciates in value rapidly so that the residual value is at risk,
- equipment which is subject to large third party risks,
- equipment provided by 'dubious' suppliers.

The common assets which can be leased may be listed as follows :

- Agricultural equipment,
- Commercial vehicles, cars, cranes, fork-lift trucks and similar handling apparatus,
- Computers, electronic machinery and office equipment,
- Wholesale / retail shop equipment,
- Telecommunication equipment (telephone, telex, etc.),
- Machine tools, printing, boring, dyeing, packaging machinery,
- Leisure equipment,
- Production lines,
- Tankers for oil companies,
- Aircraft and marine,
- Hospital and hotel equipment,
- Office furniture, shop fittings and supermarket equipment.

It seems that almost anything is leaseable. However, the most common items leased are computers and related equipment, cars and commercial vehicles. The question of administrative control of assets and ease of identification are seen as being important in deciding what is leaseable.

2.1.4.7 Leasing and other economic factors

Leasing is considered a source of financing provided by the lessor to the lessee. The lessee receives the service of a certain fixed asset for a specified period of time. In exchange for the use of this asset, the lessee commits himself to a fixed periodic payment.

The economic environment in many countries has been relatively conducive to leasing. The uniqueness of the leasing mechanism, however, has been complicated by interaction between economic factors, tax legislation and accounting practices. Leasing has therefore followed different evolutionary forms of development as a result of different domestic conditions in different countries.

2.1.4.7.1 Leasing and tax considerations

For tax purposes a lease can be treated either as an operational lease or a financial lease. Tax consequences depend on many complex factors that can influence whether a company should lease or purchase. If the company leases an asset, it saves the purchase price but loses depreciation tax concession. Lease payments can generally be treated as tax-deductible expenditures on a firm's income statement. A lease payment therefore can be deducted from the firm's pre-tax income for the period in which the payment is made. Tax considerations, of course, cannot alone determine whether a firm should purchase or lease an asset, but the tax-deductibility of lease payments often makes leasing competitive with other alternatives of borrowing finance to purchase an asset.

There is a large financial literature which concentrates on tax-related incentives to lease or buy (see Gordon (1974), Myers et al. (1976), Miller and Upton (1976), Lewellen et al. (1976), Frank and Hodges (1978, 1987), Brealey and Young (1980), Idol (1980), Smith and Wakeman (1985), Drury (1986), Heaton (1986), and Edwards and Mayer (1991)). Some of these studies attempt to establish why lessees prefer to lease assets rather than to purchase. The general consensus is that taxation is generally a very significant factor in the decision to lease.

On the other hand, the study of Fawthrop and Terry (1975) indicated that for more than half of the 54 respondents, the tax consideration in their decision on leasing was however irrelevant. Sykes (1976) and Tomkins et al.(1979) conclude that there was little tendency to lease for tax reasons.

According to Smith and Wakeman (1985)

> " taxes are important in determining the identity of lessor and lessee, but are less important in identifying specific assets to be leased. Tax provisions offer little explanation for the choice of the specific provisions in a lease contract such as metering, service provision or limitation on use."

They identify eight non-tax incentives to lease or buy, rather than taxes; these are :

1. Financial incentives of leases.
2. Compensation-related incentives to lease.
3. Specialisation in risk bearing.
4. Sensitivity to use and maintenance decisions.
5. Firm-specific asset.
6. Expected period of asset use.

7. Price discrimination opportunities.
8. Comparative advantage in disposing of the asset.

2.1.4.7.2 Leasing and accounting

Lease payments can be shown as operating expenses on a firm's income statement, but under curtain conditions (in the USA and the UK, under operational leases) neither the leased assets nor the liabilities under the lease contract appear on the lessee's balance sheet. For this reason, leasing is often called " off-balance sheet " financing. The firm is required only to add a brief footnote to its accounts describing its lease obligations. Accounting standards now require that all financial leases be capitalised, that is, the present value of the lease payments must be calculated and shown alongside debt on the right-hand side of the balance sheet. The same amount must also be shown as an asset on the left-hand side of the balance sheet (Brealey and Myers, 1988).

In order to implement this requirement, a lease is classified as an operational or capital (financial) lease. If a lease is classified a financial lease, it is accordingly capitalised and shown directly on the balance sheet.

In the UK, new provisions which became mandatory in 1987 require all leasing obligations to be capitalised, subject to a periodic depreciation change, with all future rentals payable to be recorded as a creditor on the balance sheet. However, operational leases do not transfer ownership risks and have therefore remained "off-balance sheet".

2.1.4.7.3 Leasing, interest rate and inflation

The decision to lease as an alternative to capital investment is strongly influenced by interest and inflation rates.

> "The interest rate is the price paid to borrow capital, while in the case of equity capital, investors expected compensation in the form of dividends and capital gains." (Brigham and Gapenski, 1985)

This is a factor which affects supply of and demand for investment capital. When a financial decision is contemplated, one crucial factor is the rate of interest used in making the decision.

A particular problem with evaluation of a leasing proposal is to decide what adjustment to make for inflation. Leasing is usually over a period of several years, and if money continues to lose purchasing power, the real outlay is less each year. Before attempting a discounted cash flow evaluation, the accountant has to reduce the payments by a factor every year to account for inflation. Accordingly, a leasing company has to discount future income in a similar manner (Aydon, 1972) (see Section 2.1.5.2.1 NPV).

Besides the tax factor there are the other possible factors which affect the leasing decision. Two such effects are discussed in detail in the literature. The first one is the "depreciation effect"; the value of depreciation tax concessions decreases with inflation, because depreciation allowances for tax purposes are based on historical costs rather than on current real values. The second factor is the "interest effect"; the value of tax subsidies on interest deductions increases in real term with inflation, because companies pay interest expenses on book value of assets instead of real value (at nominal rather than real rates).

This interest effect is formulated mathematically by Hochman and Rabinovitch (1984) as follows :

$$r^* = (1-t)r - \frac{t\pi}{1+\pi} \tag{2.1}$$

where

r^* = real cost of borrowing

r = real interest rate

t = corporate tax rate

π = inflation rate

with no inflation anticipated,

$$r^* = (1-t)r \tag{2.2}$$

Leasing offers a means of continuing to be able to acquire the use of new assets under more favourable cost and cash flow conditions than is the case for other forms of financing. Leasing can improve the efficiency of capital markets by spreading the effect of the capital allowances and providing a cheap form of finance which might not otherwise be forthcoming from other sources. Leasing therefore can have a major impact on the investment behaviour of a company and particularly the economy as a whole.

2.1.5 LEASING EVALUATION

Lease-purchase or lease-buy is a decision that commonly confronts firms contemplating the acquisition of new assets. Once the acquisition decision has been made, the decision to choose a method of financing for the particular acquisition can be considered. The basic alternatives available are:

1. to lease the assets,
2. to borrow in order to purchase the assets, or
3. to purchase the assets using available liquid asset.

Alternatives (2) and (3), although they differ, can be analysed in a similar fashion (Gitman, 1976).

Because a lease is a financing method, the most obvious question is, how much does it cost ? This requires that the lease offer be compared with other alternatives. Loans may be hard to get because the firm is young, or having trading difficulties, or because of a general credit squeeze. The firm's market may be expanding faster than its ability to obtain finance, particularly if the stock market is depressed. In all such cases, leasing may be appropriate. A loan has a stated rate of interest and provided one allows for tax and inflation, it is easy to assess what the cost is; however, a lease is the loan of money in the form of equipment, repaid by rentals which are capital and interest combined. It is further complicated by such matters as the residual value of the equipment, and the timing of tax reliefs.

Bierman (1982) maintains that there are three basic problems in analysing a buy-versus-lease decision. The first one is the definition of the cash flows to be used. The second one is the choice of the appropriate rate of discount. The third problem is to match the appropriate rate of discount to cash inflow.

Chasteen (1973) suggests that two factors must be considered in every lease-versus-buy decision. One is the implicit interest rate in the lease payments as compared to the rate at which the company can borrow money; the second factor is the tax shield effect of the non-interest deduction on lease payments as compared to permitted depreciation tax concession.

Both the lessee and the lessor, using independent criteria, have to evaluate the conditions of the lease. Lease evaluation techniques therefore can serve different purposes. For the lessee, the main objective is to assess whether leasing is more attractive than outright purchase or an alternative financial lease. For the lessor, the objective is to ascertain that investment of capital in leasing is a better alternative than in investing capital elsewhere. Again, lease evaluation techniques are necessary for the lessor to ensure that he can offer rental rates to the lessee which are attractive and competitive. In a free market it can be expected that a compromise is reached with an appropriate rate of return on capital for the lessor and rental rates for the lessee which are an attractive alternative to purchase.

Lo (1988) points out the lessor's objectives as follows :

1. Setting a competitive rental level to bring a required profit at a given cost of finance.

2. Offering a leasing structure that meets the lessee's needs, without impairing his rate of return on investment by comparing the profitability of alternative leasing structures.
3. Demonstrating to the lessee the benefits gained from leasing while negotiating the rental level to be charged.
4. Assessing the anticipated overall profitability of a leasing transaction before entering into it.
5. Determining whether the rate of return on the lease exceeds the lessor's opportunity cost of capital; equivalently, whether the NPV of the lease exceeds zero.

According to Weston and Brigham (1978), there are a number of other factors which could influence the cost of leasing versus purchase of assets by the user firm. These are:

1. Different cost of capital for the lessor versus the user firm.
2. Financing cost higher in leasing.
3. Differences in maintenance cost.
4. Benefits of residual values to the owner of the asset.
5. Possibility of reducing obsolescence cost by leasing firms.
6. Possibility of increased credit availability under leasing.
7. More favourable tax treatment, such as more rapid write-off.
8. Possible differences in the ability to utilise tax reduction opportunities.

In evaluating financing alternatives of leasing and borrow-and-buy, cash flows which occur over the life-time of the asset must be compared. Consequently, a method of comparison is needed which takes account of changes in the value of money with time.

2.1.5.1 Time value of money

Before entering a discussion on leasing evaluation methods it is worthwhile to look at the nature of variation with time of the value of money. The relationship between value of money today and money in the future is known as the time value of money.

Pike and Dobbins (1986) identify four reasons for changes in value of money.

1. ***Inflation*** Under inflationary conditions the value of money declines.
2. ***Risk*** 1$ of today is more certain than 1$ received tomorrow.
3. ***Personal consumption preferences*** Individuals generally have a strong preference for immediate rather than delayed consumption.
4. ***Investment opportunities*** Even when the above reasons are ignored, the fact still remains that money has a price. Given the choice of a certain money now or the same amount in one year's time, it is generally preferable to take the money now because it can be invested over the next year and it can produce a certain amount of profit / interest at the end of one year.

The future value of \$X at the end of n periods can be calculated as

$$FV = \$X(1+r)^n \tag{2.3}$$

where

r = interest rate

The present value of \$X receivable in n periods is calculated from the expression below:

$$PV = \frac{\$X}{(1+r)^n} \tag{2.4}$$

One of the much debated topics in financial leasing is which analysis technique for the lease-borrow-buy decision should be used. Controversy regarding economic analysis of financial leases concerns whether a net present value or internal net return model should be used. These models are described and discussed in Sections 2.1.5.2.1 and 2.1.5.2.2.

2.1.5.2 Leasing evaluation methods

According to Ofer (1976), leasing represents simultaneously an investment and financial decision with a leased asset generating both operational cash and financial cash flows. The investment decision is essentially how much cash not to consume in the present in order that more may be consumed in the future. Several different techniques are used in order to evaluate investment performance; these are summarised by Pike and Dobbins (1986) as follows:

1. Net present value (NPV).
2. Internal rate of return (IRR) or yield.

3. Profitability index or cost benefit ratio.
4. Payback period.
5. Discounted payback period.
6. Return on capital employed (or accounting rate of return - ARR).
7. Effect on earnings per share.

Once the projected cash flows have been identified, the next steps are:

- Specify the required return for the project.
- Use the cash flows and the required return to calculate alternatives for lease decision, either lease or purchase outright.

Among these techniques the most important and most widely used according to Hull (1980), Lumby (1988), Copeland and Weston (1988), Knott (1991), Van Horne (1992) are :

- payback method,
- accounting rate of return,
- net present value, and
- internal rate of return.

These four methods, which are particularly relevant to the present research, are now described and discussed.

Payback method: The payback period for a project is simply the number of years it takes to recover the initial cash outlay on a project. It is a ratio of the initial fixed investment over the annual cash flows for the recovery period. If the payback period calculated is less than some maximum acceptable payback period, the proposal is accepted; if not, it is rejected. There are two ways in which the payback method can be used as a guide to investment decision making. The first is when a decision maker faces a straight accept-or-reject decision; it can provide a rule whereby the project is only accepted if the initial investment outlay is paid back within a certain predetermined time. The second is that it can provide a rule when there needs to be a comparison of the relative desirability of several mutually exclusive investments. In such cases projects can be ranked on the basis of speed of payback, so that the fastest is the most favoured and the slowest is the least favoured. The project which paid back quickest would thus be chosen for investment.

Many writers agree on the major shortcomings of payback as follows:

- It does not consider all cash flows; it in fact ignores cash flows after the payback period of the project.
- It does not take account of the time value of the cash flows during the payback period. However, this difficulty can easily be overcome by applying the method to present value of cash flows. In such circumstances, the technique is usually referred to as *discounted payback period*.

Accounting rate of return (ARR): This technique is also called average rate of return or the return on capital employed (Lumby, 1988, Pike and Dobbins, 1986). This accounting measure represents the ratio of average annual profits after taxes to the initial cash outlay of investment in the project. Pike and Dobbins (1986) remark that this technique may help managers in four areas:

1. In comparing this year's performance with the previous year's performance,
2. in comparing the company's performance with its competitors,
3. in comparing actual performance with targeted performance,
4. in making financial plans.

There are a number of problems associated with ARR;these are :

1. There is no general agreement on the definition of profit (for instance, whether profit should be calculated after or before any allowances for taxation).
2. It uses accounting profits instead of cash flows and therefore fails to take account of the timing of inflows and outflows.
3. It also, like the payback method, ignores the time value of money. Benefits in the last year are valued the same as benefits in the first year.

Because of the various shortcomings in the payback method and the accounting rate of return, particularly the failure to take account of the time value of money, it is generally believed that *discounted cash-flow methods* provide a more objective basis for evaluating and selecting an investment project. The two discounted cash-flows methods, namely net present value (NPV) and internal rate of return (IRR), take account of both the magnitude and the timing of expected cash flows in each period of a project's life.

2.1.5.2.1 Net present value method (NPV)

A project's net present value is determined by summing the discounted cash flows using a rate which reflects the value of an equivalent investment on the capital market, and deducting the initial outlay. A net present value calculation simply converts all the cash flows from a project, including the initial outlay, into their equivalents in current value and sums them. The total shows how much the project is worth; if the project's NPV is positive it is economically attractive and will be accepted, but if NPV is negative it will be rejected. The NPV is illustrated as follows:

$$NPV = \sum_{t=1}^{n} \frac{A_t}{(1+k)^t} - C \tag{2.5}$$

where

A_t = expected net cash inflows

k = required rate of return on the project

C = initial capital outlay

n = project life

t = number of periods

The NPV method is widely used because it is easy to understand and to implement. This method is discussed by authors such as Ofer (1976), Hull and Hubbard (1980), Young (1984), Drury (1986), and Copeland and Weston (1988), who all used this method with after-tax marginal borrowing rates in their evaluation calculations.

2.1.5.2.2 Internal rate of return (IRR)

The second popular discounted cash flow evaluation method is the internal rate of return, sometimes called the yield. The study of Anderson and Martin (1977), whose survey included the 200 largest industrial firms in the United States, shows that the internal rate of return model and net present value technique are the most popular approaches. Over 70 % of respondents used either one or other of these methods.

The IRR represents the discount rate which equates the expected net cash inflows with the initial outlay. The calculation of IRR may be represented as:

$$\sum_{t=1}^{n} \frac{At}{(1+r)^t} - C = 0 \qquad (2.6)$$

where

r = rate of return which gives a zero NPV,

all the other symbols are the same as for the NPV formula.

The parameter of interest for the decision process is the value of r satisfying Equation (2.6) Since r is only given implicitly, it is necessary to solve Equation (2.6) numerically using Newton iteration or some other similar method. Having obtained this value of r, if this value is greater than the market interest rate, the project is accepted, otherwise it is rejected. Again, if one has to choose between a number of alternatives the decision corresponding to the one with the largest value of r should be accepted. In practice, the real decision problem is not solved, because different market values of interest are available dependent upon the degree of risk interest with where and how one invests the money.

In the vast majority of cases the IRR method of analysis for the lease-buy decision results in choosing the same alternative as that given by NPV.

On balance, Hirst (1988) has recommended the use of IRR over NPV for the lease-buy decision for the following reasons:

1. Leasing is a form of finance and it is natural to think of cost as an annual percentage rate.
2. The mathematical difficulties of using IRR are not likely to be serious in the leasing case.
3. The NPV of a lease is conceptually difficult to understand.

Also, Pike and Neale (1993) claim that a survey carried out indicates that managers prefer IRR to NPV because of:

1. Comparison between alternatives is simplified by ranking projects according to their rate of return.
2. Psychologically, managers prefer a measure of investment which is expressed in percentage terms.
3. IRR permits separation of calculation from its application as a decision rule.

Beechy (1969), Roenfeldt and Osteryoung (1973), and Findlay (1975) also prefer and recommend IRR.

Beechy (1970) maintains that both IRR and NPV methods can be formulated with one expression :

$$NPV = \sum_{t=0}^{n} \frac{C_t}{(1+r)^t} \tag{2.7}$$

where

C_t = net cash flow in period (t)

r = internal rate of return

Both NPV and IRR methods are however deficient, inasmuch that neither of them can deal satisfactorily with uncertainties in parameters such as C_t and r.

2.1.5.3 Development of leasing evaluation

In the lease versus borrow-purchase decision process certain assumptions need to be examined. Lo (1988) points out that

> "The basic assumptions of leasing evaluation are developed as a result of writers attempting to improve on the weakness of their predecessors' models, or on defending the previous models' correctness as a reflecting of reality".

The major assumptions are

1. Leasing decisions are financial decisions and should follow the investment decision.

2. Leasing finance is an alternative and equivalent to borrowing and does not affect debt capacity.
3. There is no residual value at the end of the primary period.
4. Intensive and term use of the asset, technological obsolescence and inflation all have an impact on leasing decision.
5. The effect of taxation is so significant on revenues and expenses. Therefore, their adjustment for after-taxes is essential in a lease-versus-purchase decision.
6. All cash inflows and outflows of each alternative should be adjusted to the time value. The net present value technique provides the time differences of the various cash flows during the economic life of the project.
7. The uncertainty about future cash flows and interest rate are ignored.

In the lease evaluation literature the purchase of the asset is normally assumed to be financed by borrowing. The cost of the asset (I) reflects the net present value of both the principal and interest payments (Bierman, 1973; Weston and Brigham, 1978)

The literature on leasing evaluation has focused mainly on financial rather than operational leases.

The discussion from now on will concentrate on financial leases because this is the standard form of leasing in Turkey.

Before a firm can take the decision to lease an asset it has to establish the real cost of leasing because it is essential to determine whether or not leasing is the best alternative method of financing. It is generally accepted and recommended that the desirability of each alternative course of investment is assessed on the basis of net present values and should also be applied to the lease or buy decision (Levy and Sarnat, 1979).

There are many differences between lease and debt. One of the earliest writers, Vancil (1961), observes that the most important differences are :

1. Direct interest costs on debt but not leases.
2. Income tax concessions are different in both cases.
3. The residual value of the equipment is greater in the debt case.
4. Leasing has to take into account auxiliary financing; this is not required for debt.

There is a large financial literature on how companies should decide whether or not to lease; for example, Vancil (1961), Bower et al. (1966), Beech (1969,1970), Johnson and Lewellen (1972), Roenfeldt and Osteryoung (1973), Bower (1973), Sartoris and Paul (1973), Nantell (1973), Gordon (1974), Schall (1974), Findlay (1975), Miller and Upton (1976), Myers et al. (1976), Offer (1976), Fawthrop and Terry (1976), Franks and Hodges (1978, 1979), Allen et al. (1979), Hull and Hubbard (1980), Brealey and Young (1980), Brick et al. (1987), Weingartner (1987), and Masse et al. (1987).

Many of these authors have pointed out that both lessee and lessor should benefit from a leasing agreement if they act rationally.

If the asset were debt financed, the lessee would be able to deduct interest payments and depreciation for tax purposes. If a company leases the asset it saves the purchase price, the only tax deduction will be for lease payments, and it also loses the depreciation tax shields.

Vancil (1961) proposed an analytical technique for making the lease decision. His technique is to find the present value of the cost of borrowing and to compare with the present value of the cost of leasing. Vancil's decision-making criterion is to choose that alternative which has the least cost in present value terms.

Later, in 1966, Bower et al. proposed a new model for the lease versus borrow decision. In their model, after the calculation of net present value of cost of borrowing and leasing, lease cost can be subtracted from borrow cost and the difference in the cost between borrowing and leasing is defined as the net financial and operating advantage of the lease (NADL). If the NADL is positive, then leasing is better than borrowing; if, however, NADL is negative, then borrowing is superior.

Beechy (1969, 1970) has also proposed a model for analysis of financial leasing. His model, internal rate of return, is structured to determine the percentage cost of borrowing and leasing as a discount rate.

The Johnson and Lewellen (1972) model, which used NPV as the criterion, is structured for the purchase versus lease decision. Therefore, no explicit interest cost is included in the model. They discount the lease payments and the lease tax shelter by the after-tax cost of borrowing while discounting the depreciation tax shelter. By using such additional variables they attempt to eradicate the flaws of earlier models.

Their model calculates the net present value of buy and lease alternatives, then subtracts the net present value of lease (if the asset is leased) from net present value of purchase (if the asset is purchased), the differences between purchase and lease of the asset being defined as ΔNPV. The decision criterion of this model is that if the result of differences of buy and lease net present value, ΔNPV, gives a positive figure, then the asset should be purchased rather than leased. Likewise, if ΔNPV is negative, then the asset should be leased rather than purchased.

Roenfeldt and Osteryoung (1973) also use a similar technique in selecting the alternative which provides the best method of financing. They observe that because they have made several adjustments to the cost of leasing to make it comparable with borrowing, their model eliminates the weakness of the previous models in four areas:

1. It focuses exclusively on the financing decision without confusing it with the investment decision.
2. Only those costs which are relevant to the method of financing are considered, and all costs are evaluated on an after-tax basis.
3. The cost of leasing is sensitive to changes in the interest rate on borrowing.
4. All costs are adjusted for risk which permits a meaningful assessment of decision alternatives

Myers, Dill and Bautista (1976) developed a model (MDB) to solve the firm's lease versus borrow problem. The model is generally regarded as an acceptable basis for financial lease evaluation. They examine the impact of different tax rates and different amounts of debt which may be displaced by the lease. Franks and Hodges (1978) later presented an evaluation formula which is a modified MDB formula to analyse in a non-taxpaying or temporary non-taxpaying position. Basically, the MDB and Franks and Hodges models compare leasing with the borrow-and-buy alternative.

From the lessee's point of view the MDB model can be represented as follows:

$$V_0 = 1 - \sum_{t=0}^{H} \frac{p_t(1-T) + b_t T}{(1+r^*)^t} \tag{2.8}$$

where

V_0 = value of lease contract at (0) period per dollar of asset leased.

H = number of periods of the lease payments.

p_t = lease payment per dollar in period (t) of asset leased.

b_t = depreciation per dollar of the leased asset's value; $b_1, b_2, \ldots, b_H$ is the depreciation schedule.

r = firm's borrowing rate.

r^*= after-tax borrowing rate [r(1−T)].

T = marginal corporate income tax rate.

Myers, Dill and Bautista (1976) observe that this lease evaluation formula is simple and easy to use. The decision-maker needs only to know the schedule of lease payments, the asset's tax depreciation schedule, the corporation's borrowing rate and its marginal tax rate. The model was designed to discount all after-tax cash flow at after-tax cost of borrowing. The need to use the after-tax rate is explained by Brealey and Myers (1988) as follows:

> "When a company lends money, it pays tax on the interest it receives. Its net return is the after-tax interest rate. When a company borrows money, it can *deduct* interest payments from its taxable

income. The net cost of borrowing is the after-tax interest rate....Therefore, to value the incremental cash flow stemming from the lease we need to discount them at the after-tax interest rate."

From the lessor's point of view the analysis is exactly the same as the lessee's (Equation (2.8)) except that the signs of all cash flows are reversed. This may be represented as:

$$V_0 = \sum_{t=0}^{H} \frac{p_t(1-T)+b_t T}{(1+r^*)^t} - 1 \qquad (2.9)$$

The value of the lease contract (V_0) for lessee and lessor is shown in Equations (2.8) and (2.9). The lessee's payments are the lessor's receipts. The lessor's positive NPV is the same as the lessee's negative NPV. Thus, the lessee's loss is the lessor's gain.

Myers, Dill and Bautista (1976) stated that

> "The only rational explanation of leasing is that both lessee and lessor benefit from it. This can occur only if the two parties' 'V_0's have a positive sum. Since the V_0's are calculated in exactly the same way, except for reversal of signs, a net benefit exists only if one or more of the variables determining V_0 differ for the lessor vs. the lessee."

In the model, lease payment (p_t) and depreciation (b_t) of the leased asset are definitely the same. Therefore, if one of the parties has a different tax rate position (T) and/ or a different borrowing rate (r) it is possible the two parties would have a positive V_0.

Many of the models in the literature are simple variants of approaches used by others. Bower (1973), in his review of a number of lease evaluation models, acknowledges that the various models disagree on very few points, and are broadly similar. The main points of disagreement, which were discussed earlier in this chapter (Section 2.1.4), are whether the leasing decision is an investment or a financial decision, the appropriate discount rates to be used, and displacement of debt by leasing.

Although there are some differences between the techniques which are discussed above, they are very similar in concept. Basically, the analysis involves two separate cash flows :

- cash flows if the asset is leased
- cash flows if the asset is purchased and financed by borrowing

A detailed evaluation model is now presented which is based on those advocated by Johnson and Lewellen (1972), Bierman (1973), Weston and Brigham (1978), and Levy and Sarnat (1979).

Lease Cash Flows

For the purpose of this model, it is assumed that the company is a taxpayer and the asset has no salvage value at the end of its (lease period) economic life. A period of n years is assumed for the lease and no depreciation tax shields are considered.

The net present value of the lease cash flow is now given by ;

$$NPV(Lease) = \sum_{t=0}^{n} \frac{(1-T)(S_t - C_t)}{(1+k)^t} - \sum_{t=0}^{n} \frac{(1-T)L_t}{(1+r\ )^t} \qquad (2.10)$$

where

L_t = annual lease rent

S_t = annual revenue from asset output

C_t = annual production cost associated with S_t

T = appropriate corporation tax rate

n = number of periods covered by the lease

k = appropriate after-tax discount rate

r = borrowing rate

Purchase Cash Flow

The NPV for purchase can similarly be derived. In this case, with the exception of I and D_t, all other variables in Equation (2.11) are the same as in Equation (2.10).

I = purchase price of asset

D_t= generated tax shields on depreciation (taxation depreciation)

The net present value of the purchase option may be represented as:

$$NPV\,(Purchase) = \sum_{t=0}^{n} \frac{(1-T)(S_t - C_t)}{(1+k)^t} + \sum_{t=0}^{n} \frac{TD_t}{(1+r\ \ )^t} - I \qquad (2.11)$$

The decision-making criterion is to select that alternative which has the least cost or select the positive cash flows in present value terms. If NPV (lease) is significantly greater than the NPV (purchase) then the decision to lease is taken; similarly, if it is significantly less one purchases. If these values are comparable then it is necessary to either implicitly or explicitly take account of the uncertainty inherent in both alternatives. This can be carried out in many cases by using sensitivity or other forms of analysis applied to one or more of the most critical variables, such as r and k in Equations (2.10) and (2.11).

In this chapter the development of leasing and definitions used in different countries are identified together with models used for the leasing-buy decision. Because different conditions and practices apply in different countries leasing decisions and policy can also vary from country to country.

CHAPTER TWO

SECTION (2)

Specific experience and history of leasing in Turkey

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SECTION (2)

SPECIFIC EXPERIENCE AND HISTORY OF LEASING IN TURKEY

2.2.1 INTRODUCTION

This chapter traces the development and growth of the Turkish leasing industry from 1987 to 1994. Leasing has been practised in Turkey for centuries with regard to land used for cultivating fruit and grain. However, modern leasing practice was only introduced after 1985 with the passing of the Turkish Government Financial Leasing Law. The first information regarding modern leasing activities appeared in 1987. In 1988 there was a phenomenal increase of 650 % over the previous year; this was because leasing activity was still only at a very low level in 1987. The corresponding figure in 1992 was 30 %. Today, the total volume of current leasing business exceeds $US 700 million (TL7300 billion) and is now approximately 2.5 % of all new annual fixed investment.

In 1987 there were only four financial leasing companies in Turkey; at the present time there are 39 companies, including private financial institutions

(PFIs), and development and investment banks (D&IBs) (see Appendix E). Of these, approximately 15% are responsible for 80% of all leasing business at present. There are also now approximately eight overseas joint ventures with Turkish companies.

2.2.2 DEVELOPMENT

Modern leasing can be considered a recent phenomenon in Turkey. Although the industry's history covers only a decade its development and growth are significant.

2.2.2.1 Financial leasing law (background)

Initiation of leasing in Turkey is unique when compared with how leasing developed in other countries, where the process generally first resulted from a solidification of existing industrial infrastructures, then was followed by regulation. In Turkey this process was reversed, with regulatory legislation coming before the formation of leasing companies which only came into existence two years later (Tekinalp, 1992).

The Financial Leasing Law (Number 3226) does not actually define what leasing is, but does lay down regulations regarding leasing companies, rental contracts, incentives, taxation, funding structure and joint ventures with overseas companies. Demiralp (1989) stated that the purpose of the Leasing Law was essentially to create an alternative mechanism for medium and long-term funding requirements for capital projects and consumer goods manufacturing where these were for the future economic development of Turkey.

Under this legislation, organisations in Turkey which are allowed to carry out leasing transactions include development and investment banks (D&IBs), private financial institutions (PFIs), and some Turkish branches or subsidiaries of approved foreign leasing companies.

The first leasing contracts were signed in 1987 and were immediately recognised as a major investment instrument by the financial market. By the end of 1989 there were twelve companies providing lease financing (see Table 2.2.1). Of these, seven companies were registered as *rental leasing companies* and, as such, were registered with the government department UTFT (Under-secretariat of Treasury and Foreign Trade) which is directly responsible to the Prime Ministry. Again, of the twelve leasing companies, four (three UTFT-registered) dominated the leasing market with a market share of 75%. Consequently, in 1989 there was not a genuine free market but an oligopoly. This oligopoly was encouraged by the legislation which stipulated that leasing companies should have a certain minimum equity of 1 billion TL. (approximately $32,000 today; see Appendix F). The requirements obviously excluded a large number of smaller organisations.

In addition to the Financial Leasing Law, the development of leasing in Turkey since 1985 has been significantly influenced by a number of other government decrees, regulations, and communiqués issued by various ministries. Examples of these additional regulatory requirements include Amendments to Regulation Governing the Period and Limitation of Financial Lease Agreements, Council of Ministers (May 1987; December 1988; July 1991);

Table 2.2.1

Growth of leasing in Turkey

Year	Number of leasing companies	Number of transactions	Leasing amount ($US million)
1987	4	177	9.1
1988	8	279	67.8
1989	12	2384	265.6
1990	20	3300	415.1
1991	24	2195	401.2
1992	38	2989	521.7
1993/(Jan.,Sept.)	39	4385	547.1

Source: UTFT, Main Economic Indicators, December, 1993 and UTFT, Main Indicators of the Turkish Financial System, September, 1993

Regulation Governing the Guaranty Requirements for Customs Duties for Cross-Border transactions, Ministry of Finance and Customs (September 1985); Stamp Duty General Communiqué, Ministry of Finance and Customs (June 1986); Annual Communiqués on the Encouragement and Orientation of Investments, Council of Ministers (March 1992).

At the present time there is pressure on the government from the leasing companies to allow sub-leasing, early cancellation of a lease agreement if both parties agree to do so, and transfer of their possession rights by lessees to any third party. On the positive side there has been very active dialogue between lessors and the various ministries and regulatory authorities concerned. A consequence of this has been that the companies' requirement of limitation on the maximum size of a single lease has been lifted (total rental receivable from a single lessee with an investment project not qualified for investment incentives cannot exceed 25 % of the lessor's equity; if this project qualified for the incentives this rate was 40 %, and if the investment project was approved by the Treasury this rate could not exceed 75 % of the lessor's equity). The limit of the total indebtedness to equity ratio of lessors has increased from 15:1 to 30:1. If the lessee is a state-owned entity this limit does not apply, provided that the transaction has been approved by both the UTFT and the State Planning Organisation (SPO) which is also directly responsible to the Prime Ministry to prepare short-and long-term plans to help realise targets set by the government and to act as a consultant for the government on economic and social issues.

Under the initial legislation of the UTFT all leases were subject to minimum lease periods of four years unless there were exceptional technological factors involved, in which case specific approval from the UTFT for a shorter period had to be obtained. This four-year period has now been reduced (October 1992) to a period relating to the life of the asset. For example, leasing periods on cars and computers can now be two years on which both parties agree.

Lessors still have a number of outstanding problems awaiting resolution; for example, they are not still allowed to sub-lease, which could be an important mechanism for reducing risk on lessors of particularly large magnitude. In order to encourage economic development in certain areas of Turkey, the government supplies incentives in the form of certain exemption from some taxes and customs duties on certain imported goods. In the case of domestic leasing these incentives apply to lessees, but if the equipment is financed by lease these incentives transfer to the lessor. However, in current Turkish legislation, if a lessee defaults in industrial activity these incentives are cancelled and the lessor must repay the liability and benefits already received for incentives. This obviously has additional financial risk from which leasing companies wish to be free. But so far there has been little progress made in removing this obligation from the lessor.

Among other problems, apart from legislated ones, that leasing companies face in Turkey is the relative shortage of available funds, especially for medium-term leases. Another problem in this area faced by the companies registered with the UTFT is the unfair advantages that PFIs and D&IBs not registered enjoy. This is because these institutions can use funds deposited or invested with them by their clients to finance their leasing activities and on which they have no tax liability, while UTFT-registered bank-affiliated (BA) and privately-owned leasing companies (POLCs) are subject to 11% tax on the interest they pay for loans they obtain to finance their operations (Kurmus, 1994).

The leasing industry in Turkey had an annual increase of approximately 300% in 1989. However, this growth rate dropped to about 60 % in 1990. As a result of the Gulf War there was a decline of 3 % in 1991. This was because Turkey was particularly vulnerable financially to the economic consequences of the war and the uncertainty it created in general economic activity. The leasing companies which had a large number of clients drawn from the tourist, construction, transport and textile sectors were particularly seriously affected by the Gulf War crisis.

2.2.3 TYPES, VOLUME AND VALUE OF LEASES

As already seen in the first section of this chapter (2.1.3.1), the above leases are divided into two basic groups, namely financial lease and operational lease. According to the regulations of the Turkish Financial Leasing Law there is no distinction between financial and operational leases (see Section 2.1.3.8). All lease agreements contracted by ' *rental leasing companies*' and empowered financial institutions in Turkey are accepted as lease agreements, regardless of any distinction. All leasing agreements in Turkey are regarded as 'financial rental' and this should be understood as financial leasing.

On the other hand, lease agreements in Turkey can be divided broadly into two groups by their market: domestic leasing, those leasing agreements where both the lessee and the lessor are domiciled in the same country, and cross-border leasing, those agreements where the lessor and the lessee are domiciled in different countries.

2.2.3.1 Domestic leasing

Of the total of the leased assets, private and commercial vehicles represent the major proportion of domestic leasing (see Table 2.2.2). A reason for this was that there were considerable VAT advantages in leasing rather than outright purchase of vehicles. Before 1991 the VAT rate on all vehicles was 15 % if purchased normally. However, if these vehicles were purchased through a leasing agreement this rate was 10 %. In June 1991 this VAT concession was withdrawn and a standard 20 % VAT rate was applied generally to all types of purchase (with the exception of commercial vehicles if they were purchased through a leasing agreement, 6%). The effects of this can be seen in Table 2.2.2. During the year 1991 vehicle leasing agreements comprised 43.3 % of all leasing activity in the year. As a result of the VAT concession being withdrawn in June, this figure dropped to 22.3 % in the following year 1992. Apart from vehicles, other main types of equipment purchase with leasing agreements in Turkey are manufacturing plant, computers, textile machinery and medical diagnostic and treatment equipment.

Table 2.2.2

Types of equipment leased in 1987-1993 (%)

Equipment type	1987	1988	1989	1990	1991	1992	93/III
Computer, office and telecommunication	**39.7**	**5.8**	**6.9**	**13.9**	**17.2**	**13.1**	**15.1**
Vehicles	**26.9**	**66.7**	**64.9**	**58.3**	**43.3**	**22.3**	**22.8**
Aircraft	-	**2.6**	-	-	**8.4**	**2.1**	**1.2**
Marine transportation	-	**0.8**	**17.2**	**4.3**	**0.5**	**3.6**	**10.1**
Textile and printing machines	**15.2**	**3.5**	**0.8**	**4.1**	**3.5**	**6.2**	**4.7**
Medical equipment	**6.4**	**2.3**	**1.0**	**3.9**	**3.2**	**4.9**	**2.2**
Other manufacturing machines	**11.0**	**18.3**	**9.2**	**15.5**	**23.9**	**47.8**	**40.6**
Real estate	-	-	-	-	-	-	**3.3**
Total	***100%***	***100%***	***100%***	***100%***	***100%***	***100%***	***100%***

Source: UTFT, Main Economic Indicators, February, December, 1993

Considering the period 1987 to 1992, it can be seen from Table 2.2.3 that in Turkey leasing transactions amount to only between 1 or 2 % of total fixed investment. This figure can be compared with corresponding figures in developing countries which vary from 10 to 30 % (see Table 2.2.4). Market penetration in Table 2.2.4 approximately corresponds to the percentage of all capital investment on equipment represented by leasing companies.

Table 2.2.3

Leasing and fixed investment in Turkey, 1987-1992

Years	Fixed investment ($US m)	Annual growth (%)	Financial leasing ($US m)	Annual growth (%)	Leasing/ investment (%)
1987	16,023.8	-	9.1	-	0.06
1988	16,939.1	5.7	67.8	647.7	0.40
1989	17,936.3	5.9	265.6	291.7	1.48
1990	24,963.2	39.2	415.1	56.3	1.66
1991	25,391.6	1.7	401.2	(3.4)	1.58
1992	26,407.2	4.0	521.7	30.0	1.98

Source: Based on SPO Main Economic Indicators, February, 1994, and UTFT Main Economic Indicators, December, 1993

Table 2.2.4

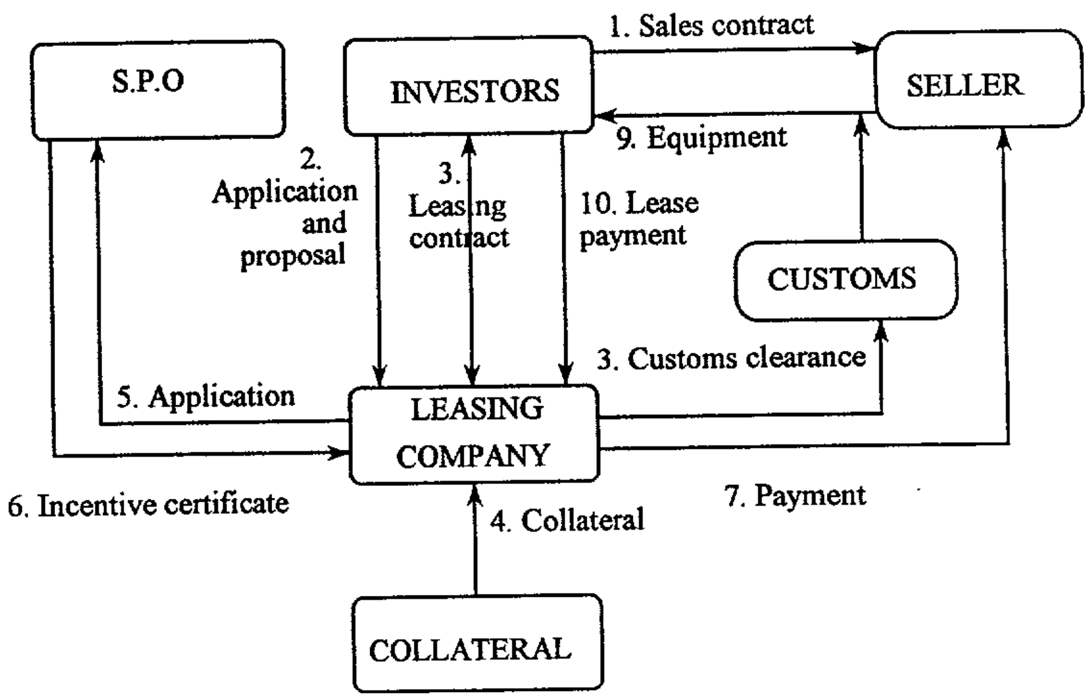
Leasing volume and market penetration in some selected countries

Country	Annual leasing volume ($US bn.) 1991 /1992		Market penetration (%) 1991/1992	
USA	123.90	120.30	32.0	32.0
UK	22.40	12.28	23.0	18.6
Korea	9.54	8.45	21.5	20.0
Australia	3.72	3.88	20.0	20.0
Spain	10.30	6.36	17.0	17.5
Germany	25.13	31.67	14.0	16.6
Canada	4.09	4.81	10.4	11.0
Japan	64.41	62.76	7.8	7.5
Venezuela	0.66	0.87	8.0	n/a
Columbia	0.30	0.57	5.6	8.2
China	1.50	1.90	1.1	1.2
India	0.52	0.50	3.4	5.0
Poland	0.07	0.10	2.2	2.6
Morocco		0.18		2.6

Source: World Leasing Yearbook 1993 and 1994

Figure 2.2.1

Procedure for domestic leasing



Source: AF&LD, November, 1991, p.18

2.2.3.2 Cross-border leasing

As can be seen in Table 2.2.5, in Turkey cross-border leasing transactions are predominantly for aircraft which are mainly leased by Turkish Airlines and some of the other private airways. The very large drop (about 71%) in total business and change in the proportion of manufacturing machinery from 1988 to 1989 was caused by the Treasury's outright refusal of permission for all cross-border lease contracts not containing high-tech machinery and equipment which has not been defined.

Table 2.2.5

Cross-border leasing in 1987-1993

Equipment type	1987	1988	1989	1990	1991	1992	93/III
Office and telecom. equipment	75.68	7.06	1.60	0	0	0	0.02
Aircraft	8.11	75.06	59.20	89.63	97.61	96.91	99.93
Marine transportation	0	0	0	0	0	0.61	0
Textile plant	2.70	0	0.80	0	0	0	0
Medical equipment	13.51	0.24	2.40	1.25	2.21	2.48	0
Other manufacturing plant	0	17.65	36.00	9.13	0.18	0	0.05
Total	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*
Value of leases ($USm)	37	425	125	241	226	622	1294
Number of leasing contracts	13	16	17	16	15	21	37

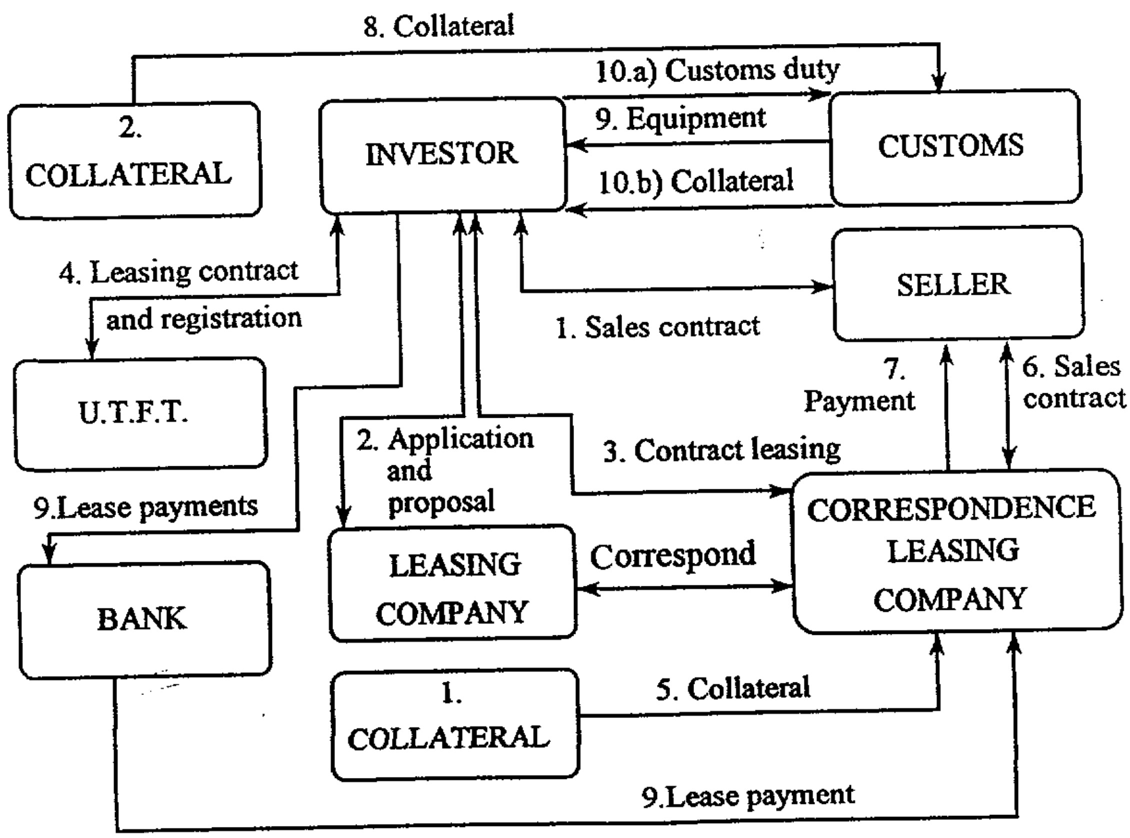
Source: UTFT, Main Economic Indicators, February-December, 1993 and Main Indicators of the Turkish Financial System, September, 1993

Cross-border leasing enjoys some advantages when compared with domestic leasing; if an equipment is leased from abroad, customs duty payable by the lessee is deferred until the end of the leasing contract. When the contract expires and if the lessee wishes to exercise a purchase option, he pays the amount which he would have paid at least two (minimum lease period) years previously. Furthermore, at the expiration of the primary term, if the lessee asks for an extension of lease, the customs taxes due are again deferred until the end of the secondary period. In a highly inflationary environment

(60-70 % annually), the amounts of deferred customs taxes payable correspond to an actual rate based on original cost of approximately 10 to 20%. However, when the equipment is first leased the lessee has to pay an additional tax of 5% (a withholding tax) which supposedly offsets the advantages of deferring tax payment. This is obviously much less than what is saved in interest charges by having deferred payment benefits.

Figure 2.2.2

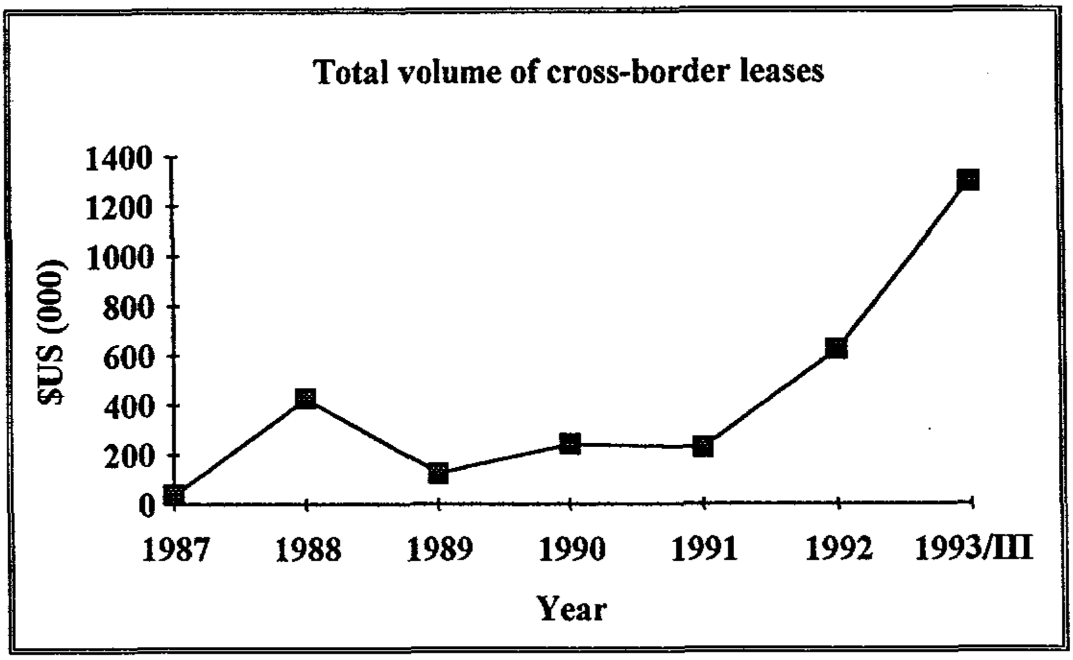
Procedure for cross-border leasing



Source: AF&LD, November, 1991, p.18

Figure 2.2.3

Total volume of cross-border leases



Source: UTFT, Main Indicators of the Turkish Financial System, September, 1992 and 1993

2.2.4 TYPES OF LESSORS

Leasing companies in Turkey can be divided broadly into four basic types:

- Bank-affiliated leasing companies,
- Development and investment banks,
- Private financial institutions,
- Privately-owned leasing companies.

The nature of each of these classes of companies will now be described and discussed in detail.

Bank-affiliated financial leasing companies (BA) in which more than 50% of the equity belongs to one or more banks, in Turkey however, normally only one. The Turkish Financial Leasing Law 3226 requires these companies, defined as *'financial leasing companies'*, to be joint-stock companies. They are required to be established, operated, and audited according to the Financial Leasing Law, and they are limited strictly to financial leasing operations and cannot carry out other operations such as accepting money or security on deposit or making investments for clients.

Development and Investment Banks (D&IBs) can conduct financial leasing transactions in addition to their other business but are subject to the same legal restrictions on leasing procedure which apply to every type of company allowed to carry out leasing transactions under the Law 3226. They are not required under this Law to establish an independent department to do their leasing transactions.

Private Financial Institutions (PFIs) are allowed to carry out financial leasing transactions but they are however regulated by a decree separate from Law 3226 (No: 83/7506, Turkish Official Gazette No: 18256, January 19, 1983). As investment and development banks they may conduct their financial leasing transactions without creating a separate company or setting up an independent department. These companies operate entirely on a conventional basis in that they purchase goods from manufacturers or dealers and supply them to clients with a suitable proper mark-up in price. The clients will often pay for these goods on an agreed instalment payment programme. These payments are formulated so that proper return on capital accrues to PFIs after allowing for an additional profit. This method of selling and purchase is a very close analogue of normal consumer hire purchase practice in western countries. Their business since 1983, and which still constitutes a major part of their activities, is the purchase of goods often in the form of equipment of different forms for subsequent sale. Leasing now accounts for approximately 10 % of the total PFI business transactions. On the other hand again, their leasing component of business accounts for approximately 14 %. PFIs also differ from the other financial leasing organisations in that they are also allowed to operate in a manner similar to banks or building societies with clients' open deposit. PFIs are also allowed to establish accounts for their clients where money is invested on their behalf and profits (losses) are returned after suitable management charges have been deducted. In many respects these accounts resemble those unit trusts which are common in the west. It is interesting to note that the majority of PFIs have origins in Middle East countries with strong Islamic cultures where there is a prohibition on earning interest in the conventional sense, but where profit or a fixed charge is allowed on real capital.

Private-owned leasing companies (POLCs) are, like BA, established, operated, and audited according to the Financial Leasing Law 3226. However, by this law they are only allowed to carry out financial leasing operations. The only difference between BA financial leasing companies and POLCs is that POLCs have no affiliations with other financial institutions.

In practice, there are differences between leasing companies whose operations are subject to Law 3226 and companies which are allowed to offer leasing services independently of this law. The main differences between PFIs and the others companies are that PFIs are allowed to raise funds directly from the public by opening investment accounts and the investments themselves are used in the leasing operations of the company. This means that PFIs as well as D&IBs, to be discussed later, can provide leasing at more favourable terms to clients than BA and POLCs; not only is it easy for them to acquire funding , but also they are not required to pay taxes, which is the case of BA and POLCs which have to pay 11 % on all interest payments for all loans they obtain to finance their leasing activities. On the other hand, PFIs and D&IBs have an additional advantage over the other two types of leasing organisations inasmuch as the law does not prescribe any limit to the level of their rentals received. By this means they are not subject to the 30:1 limit on the total indebtedness equity ratio. This gives them a competitive advantage over other institutions with regard to clients who wish to lease high capital cost equipment.

2.2.5 LEASING ASSOCIATIONS

The four types of leasing organisations operating in Turkey belong to one or other professional organisations. Leaseclub is a European-based association with members predominantly from Europe, but also from other occasional countries such as Japan and Morocco, established in 1970. Of the four organisations, the BA organisations in the main are members of Leaseclub; this is because they see themselves clearly identified under Turkish Law as leasing companies. The other groups, POLCs, PFIs and D&IBs in the main belong to FIKAD, a purely Turkish organisation. This second one, FIKAD, Financial Leasing Research and Solidarity Association, was set up in July

1992. The objectives of FIKAD are to develop, prosper and strengthen the leasing sector of Turkey, and to further the needs of its members. At the present time there are 20 fully paid-up members of FIKAD; from 13 leasing companies, the number of Turkish leasing companies subscribing to Leaseclub is 15.

2.2.6 LEGAL AND FINANCIAL ENVIRONMENT

The first leasing company, established after the enabling legislation of 1985, was Iktisat Leasing, in 1986. Since then, a number of other companies have entered the market, most are subsidiaries of leading Turkish banks.

2.2.6.1 Establishment requirements for lessors

In Turkey a leasing company must be established as a form of joint-stock company. The establishment of new leasing companies and opening of a branch of a domestic and an overseas company must be approved by the ministry which is responsible to the Under-secretariat of Treasury and Foreign Trade (UTFT), the body responsible for financial institutions, commercial, and foreign trade of Turkey and which is responsible directly to the Prime Ministry. From this, it can be seen that leasing is considered by the Turkish government to be strategically important for future economic development. Being a joint-stock company, a leasing company is also governed by the provision of the Turkish Commercial Code relating to joint-stock companies.

The share capital of a domestic financial leasing company may not be less than 1 billion Turkish Lira (TL) (it is proposed to increase this to TL 15 billion) which at the current rate of exchange is approximately $US 35,000.

The guaranteed share capital for a foreign leasing company branch has to be at least in Turkish Lira the equivalent to $US 2 million.

As leasing companies are not confined to purely leasing activities, PFIs and D&IBs not established as a leasing company can also engage in leasing activities. The 1985 legislation does not require organisations whose leasing activities are only minor functions of their general activities to register with the UTFT.

2.2.6.2 Operation

The Turkish leasing industry is closely controlled and regulated by the UTFT, and there are many regulations regarding it contained in the Financial Leasing Law (No: 3226) and other public body regulations. However, there is no specific definition anywhere in Turkish law as to what constitutes leasing. All leasing transactions are normally conducted in either Turkish Lira or a convertible currency; cross-border leasing agreements involving a foreign country have to be specially approved by the UTFT, and the annual value of leasing payments of a cross-border leasing cannot be less than $US 25,000.

Leasing companies are required to provide quarterly financial statements to the UTFT on their activities, detailing the current position on each lease they have made. Leasing companies are also required to report on each lease within 20 days of the leasing contract being signed with a form provided by the Ministry (see Appendix G). Under Turkish financial leasing agreements any asset of a material nature can be leased whether it is movable or fixed.

2.2.6.3 Lease agreements

All lease agreements must be drawn up by a public notary and the following observed.

- movable assets must be registered with a public notary located in the domicile of the lessee,
- any contract relating to real estate must be registered in the land registry where the property is already registered, and
- contracts related to shipping must be registered with the marine registry.

All leasing contracts normally must have a minimum term of four years and can not be terminated in that period even if both parties were to agree to do so. Exceptions to this are:

1. Where assets leased have a useful life of less than four years in accordance with criteria laid down by the UTFT.
2. The assets are the subject of a new contract that is an extension of previous contract(s).
3. The assets are destroyed or materially damaged as result of war, sabotage or natural disaster.
4. The lessor and the lessee are suffering major economic and financial difficulties, as indirect consequences of actual war, sabotage or disasters in a neighbouring country.

It is of interest to note that 3 and 4 were only introduced in the aftermath of the Gulf War 1991.

2.2.6.4 Funding

A major difficulty resulting from current Turkish legislation is that of fund mobilisation, i.e. acquiring the necessary capital to finance the purchase of assets prior to leasing. Financial leasing companies are not allowed to engage in activities which are not directly related to financial leasing. However, non-deposit development / investment banks as well as deposit-taking PFIs are exempted. Leasing companies may, for their operation, create funds on the securities market through issue of corporate bonds, debentures, and other commercial papers within the country and abroad within the framework of the relevant laws (Capital Markets Law No: 2449) and other legislation. Another source of funding is loans, which financial leasing companies receive from banks; however, insurance companies and other financial institutions are subject to banking and insurance transaction tax. Another important source of funding for financial leasing companies is re-discount facilities provided by the Central Bank of the Republic of Turkey.

2.2.6.5 Investment incentives

Under the Turkish Government Five Year Development Plans, the State Planning Organisation publishes annually a list of geographical areas and economic sectors where certain investment projects can qualify for special incentives. An incentive certificate issued to a lessee can be transferred to the lessor as it is legally the owner of the property, provided that both the lessee and lessor are domiciled in Turkey. However, there are financial limits on these incentives; any new investment project with asset acquisition cost less than TL5 billion (approximately $US 170,000) cannot qualify for incentives for industrial equipment. But no such limits apply for computer software development, tourism, garment manufacture, and for plant modernisation and expansion costing more than TL 1 billion (approximately $US 32,000). Used machinery and equipment, with the exception of aircraft and marine, which are purchased from abroad and are subsequently leased, can not qualify for an investment incentive certificate. However, construction equipment machinery purchased abroad, provided it is not subject to a financial leasing agreement, can qualify for investment incentive certificates.

These investment incentives include 100% import tax exemption and investment tax allowances of between 30 to 100% of the total fixed investment cost. The degree of exemption depends upon geographical location, industrial sector and the size of investment. In the event of the lessee defaulting on his payments the lessor must repay the total value of incentives received. This obviously imposes an additional financial risk on lessors. An exception for this responsibility is if either the lessee or lessor declares bankruptcy.

2.2.6.6 Tax legislation

Corporation tax on gross income in Turkey prior to 1994 was 46%. In the January 1994 Budget this was reduced to 25%. Corporation tax is paid in three equal instalments; however, the tax on company profits can be deferred for three years if this profit is reinvested in new fixed assets, and again, losses can be offset against future tax payments on future profits. Lease agreements are not subject to the Fiscal Stamp Duty Tax and other charges applicable to other agreements. All rental payments received by lessors are recognised as income and are taxable as such. However, all rental payments made by lessees are tax-deductible.

Currently, leasing companies are required to charge 1% VAT on all items, with the exception of trucks and commercial vehicles, where the VAT rate is 8%, and cars, which have a 23% VAT rating. This can be compared with the corresponding VAT ratings of 15 %, 15 %. and 23 %, respectively, on those goods if purchased normally. It is seen that with the exception of cars there are significant financial advantages with regard to VAT in leasing as opposed to outright purchase.

2.2.6.7 Leased asset insurance

According to the Financial Leasing Law Article 17, the lessors are required to ensure that leased assets are insured for the full term of the lease. However, Article 17 requests the lessees to pay actual insurance premiums. Whilst the first responsibility for the selection of the insurance company and negotiating of policy resides with the lessor, in practice this is often done after consulting with the lessee. The lessee, by Article 13, is also obliged to use assets with proper care. The lessee is also required, unless otherwise stipulated in the contract, to be responsible for maintenance and protection. The lessee is also required to bear the cost of all maintenance and repairs which are outside the original manufacturers' warranties. In the event of an asset being damaged, and it can be demonstrated that the lessee is culpable, the lessor has the right to demand compensation for the damage and has the option to terminate the contract.

In the case of a lessee being declared bankrupt, Articles 19 and 20 provide protection for both lessor and lessee, inasmuch that any leased assets are not treated as assets of the lessor until lease agreements expire.

2.2.6.8 Accounting practices

At present in Turkey there are no commonly accepted accounting standards used by both lessees and lessees in leasing transactions. Financial leasing companies keep their accounts according to Turkish Tax Procedural Law, leased assets are recorded by the lessors as fixed assets subject to predetermined depreciation cover over the economic lives of the assets. However, leased assets values do not appear in company balance sheet and reports.

It can be argued that, with this non-reporting of leased assets, a true picture of a company's potential liabilities is not presented.

The International body of the Accounting Standards Committee (IASC) recommended in 1982, by issuing Standard 17, that all lessees' balance sheets should have statements listing any leased assets and associated liabilities; also, IAS 17 requires that the lessor should record any asset held under a finance lease. A survey of use and application of international accounting standards published in 1993 shows that 41 countries have national standards, law or practice that conform with IAS 17 in all material respects; these include Belgium, Canada, Hong Kong, Portugal, the UK and the USA. This is not so in Turkey (Cairns, WLY, 1994, p.44).

In Turkey, all leased asset payments received by lessors must be shown as income for the relevant rental periods and invoice date. These are therefore taxable; however, the lessee rental payments, as described earlier, are tax deductible.

CHAPTER THREE

Research methodology

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 INTRODUCTION

This chapter presents the methodology used in collecting and analysing the data for this research.

The aim of the research is to investigate leasing practice in Turkey and identify various aspects of motivation and the factors influencing the leasing decision, and to assess the nature and extent of both lessors' and lessees' past, current, and future activities, rather than to test a specific theory.

The personal interview is one of the most common methods by which data are collected. Although this method has the advantage of permitting in-depth questioning and eliciting a high response, it is a costly method of acquiring data in terms of time and money and accordingly was not used for the present research.

These constraints and the exploratory nature of the study led therefore to the decision to use a mail questionnaire. Although the major problems associated with a postal questionnaire are low response and less reliable information, it does however have the advantage of permitting coverage with widely-spread samples and allowing respondents time to give careful consideration to it and provide detailed replies. Respondents may also be more willing to answer questions than when they are confronted by the interviewer (see Berdie, Anderson, and Niebuhr, 1986; Jackson and Parkinson, 1989; and Oppenheim, 1992).

The research data presented in this study were obtained from three main sources.

1. *Library research* directed towards determining theoretical and practical issues which have been presented concerning leases. Attention was given particularly to the relevant legal, financing and accounting literature concerned with lessors and lessees.

2. *Official documents and publications* in Turkey related to financial and economic reports and indicators, together with legislation concerned with leasing, lessors and lessees.

3. *Responses to questionnaires* mailed to leasing companies and lessees and potential lessees in Turkey.

In addition, a number of lessors and lessees provided extra information and data, such as the lease agreement process, copies of their lease agreement, and financial statements of companies.

For the research two separate questionnaires were formulated and designed for lessors and lessees domiciled in Turkey, based on the literature and surveys in other areas. Copies of these questionnaires are given in Appendices A and B.

3.2 PERIOD OF THE STUDY

Data were obtained in the lessors' and the lessees' questionnaires for the period 1987 to 1992 inclusive. The year 1987 was chosen as the first year of the sample since it is the first year in which leasing agreements were negotiated in Turkey. The last date relates to the time when the questionnaires were mailed. They were sent out during the period April to August 1993.

3.3 LESSORS' QUESTIONNAIRE

The questionnaire was designed and distributed to obtain specific information about leasing practices of leasing companies in Turkey. This section discusses the design of the lessors' postal questionnaire and the selection of the sample of leasing companies in Turkey to which the questionnaire was sent.

3.3.1 Questionnaire development

The initial questionnaire was prepared following the extensive review of the leasing literature and previous related empirical studies in other areas. Before the final format was designed, various drafts of the questionnaire were produced, then modified and adapted to the Turkish leasing industry after discussion with the researcher's academic adviser.

The questionnaire, initially prepared in English, was then translated into the Turkish language. The consistency of the Turkish version was ensured by checking with other Turkish-speaking students who were Ph.D candidates in economics, business management and banking studies.

The lessors' postal questionnaire was designed to achieve the following objectives:

1. To assess the nature and performance of leasing companies active in the leasing business in Turkey between 1987 and 1992.
2. To identify the type and volume of leased assets, and factors influencing general leasing business in the lease market.
3. To identify the relationship between leasing companies and lessees/ potential lessees concerning leasing transactions.

In addition, answers to the following points were also sought:

1. Type of sources which leasing companies use to finance their leasing transactions.
2. Type and location of customers.
3. Accounting practices and prospects for the leasing industry.

In order to facilitate the answering of the questionnaire, the questions were arranged in a way that followed the question flow and categorisation, as in Appendix A. The questionnaire was divided into the following areas:

1. *Nature of the leasing companies*: Included the year the leasing company was founded (Q1), entity (Q2 and Q5), status of ownership of the company (Q3, and Q33), leasing associations of which the company is a member (Q4). The main purpose was to identify the general background of leasing companies.

2. *Perceptions and attitudes*: Identified how company staff were trained (Q8), expectations of leasing market in general (Q35), companies' particular sector (Q36), and companies' plans for future leasing activities (Q37 and 38).

3. *Motivation for leasing*: Identified factors, motivations and why lessees lease (Q13), and reasons for the attractiveness of leasing (Q9)

4. *Leasing activities*: Included type of lease contracts (Q7), the nature of leases in terms of number and volume (Q19 and 26), leasing size (Q27), type of equipment leased (Q23), and seasonal business volume (Q28).

5. *Relation with customers*: Asked how leasing companies inform and influence the lessees in their choice (Q10, Q20 and Q21), information required before entering lease agreements (Q11), type (Q25) and regional distribution (Q24) of customers.

6. *The effect of taxes*: Presented the effect of the VAT rate increase in 1989 on leasing business (Q14 and Q16), and on some other factors (Q15), and volume of tax free business (Q18).

7. *Accounting records and leasing evaluation methods*: Included methods used for evaluation of lease proposals (Q12), methods for determining economic life of leased equipment (Q30), depreciation methods (Q31), and recording on companies' balance sheets (Q32).

8. *Performance of company*: Presented volume of leasing business in total financial activity (Q6), companies' profit (Q17), assessment of companies' performance with regard to their leasing activity (Q29), and companies' growth (Q34).

Question 22 examined types of funds which finance companies' leasing activities.

The last two questions in the questionnaire, Q39 and Q40, were designed as open-ended for respondents to discuss and give additional brief ideas or comments concerning whether there are any actions which Turkish authority should and could take in order to improve leasing activity (Q39), and any specific factor(s) which can affect future demand for leasing in Turkey (Q40).

3.3.2 Population and sampling criteria

Initially, it was decided to study all the leasing companies which were active at the time of research. The 1993 World Leasing Yearbook, Turkey section, reported that there were 27 active leasing companies in Turkey, including four private financial institutions, five development and investment banks, and eighteen leasing companies registered as leasing companies with UTFT. On the other hand, according to the UTFT main economic indicators, in February 1993 there were 33 leasing companies active.

Therefore, before mailing the questionnaire to the lessors, a letter was sent to the lessors' associations in Turkey, namely to Leaseclub and FIKAD, in order to obtain the names and addresses of leasing companies, and the names of the managing directors, with a brief explanation of the study being undertaken.

A total of 38 leasing companies for the sample was therefore drawn from two sources:

1. The World Leasing Yearbook 1991, 1992 and 1993,
2. Leasing associations: Leaseclub and FIKAD.

After the leasing companies' names and addresses were obtained from the leasing associations, a letter was then sent with brief information about the research to each of the companies, asking them to provide names and addresses of lessees with which they have had leasing contracts. By sending these letters to the leasing companies, the author aimed to encourage the lessors to complete the questionnaire which was going to be sent to them subsequently.

The questionnaire was distributed from April 1993 to August 1993, together with a covering letter from the researcher's academic adviser (Dr. A Z Keller), and another letter from the researcher written in Turkish, which described the aim of the research and the method of response requested. The initial mailing to the 38 leasing companies was carried out in the first week of April 1993. Two months later, in the first week of June 1993, a reminder (see Appendix C), and 6 weeks later, in mid-August 1993, another copy of the questionnaire together with another reminder letter (see Appendix D), were sent to non-respondents.

In distributing the questionnaire a number of standard survey techniques suggested by Singhvi (1981) were employed, in an effort to achieve a reasonable response rate. These included:

1. Personalised addresses on the envelopes and on covering letters.
2. Pre-addressed envelopes for the return of the questionnaire.
3. Respondents were assured in the covering letter that confidential information will not be disclosed under any circumstances.
4. An offer of survey results to respondent companies.
5. As described above, a letter was sent in advance, and two follow-up letters were sent to non-respondents along with another copy of the questionnaire with a return envelope.
6. Before sending the third copy of the questionnaire to the non-respondents, telephone calls were also made.

Following the completion of the procedure detailed above, within six months a total of 21 replies were received, representing a response rate of 55.3% (the response rate does not include the questionnaires returned as undelivered, numbering 2).

Of the 21 returned questionnaires, 16 were valid for analysis, the remaining 5 replies were rejected for the following reasons:

1. Three were returned uncompleted from companies which claimed they were not in the leasing business as lessor.

2. One was returned uncompleted from a company (PFI) which, although empowered to carry out leasing transactions, had not completed any leasing agreement up to the time of the questionnaire.

3. One leasing company declined to participate, on account of concern about the confidentially of the information requested.

Though small in number, 16 useful replies was a reasonable reply rate when compared with the return for other questionnaires for similar studies in the literature. McGuan and Caves (1974) had a useful response rate of 22% (54/343) in their survey of the equipment leasing industry in the USA. In the UK, 45.1% (17/38) was achieved by Tomkins et al. (1979) in their survey of the financial leasing industry. Hull and Hubbard (1980) and Lo (1988) also achieved 24% (32/132) and 41% (92/224) useful response rate, respectively, in their study of financial leasing practice in the UK.

In addition to the completed questionnaire considerable other useful information was also received, including lease agreement procedures, copies of leasing agreements, and accounting records of actual lease assets. A letter of thanks was sent to each of the respondent companies; in this letter respondents were also asked to give a possible time for an interview to take place in their office. Unfortunately, only one respondent replied positively.

3.3.3 Analysis and presentation of data

Keller, Warrack and Bartel (1990) claim that most studies in business and economics encounter numerous opportunities to make valuable use of descriptive statistics when preparing reports and presentations. This method involves arranging, summarising, and presenting data in such a way that meaningful essential data can be extracted and understood easily.

According to Jackson and Parkinson (1989), the use of descriptive statistics enables one to describe the shape and the characteristics of distributions and comparisons in a precise and objective way.

Data for this study were accordingly analysed and interpreted mainly by the use of descriptive statistics. Since most of the data supplied were subjective and descriptive in nature, it was therefore judged that descriptive analysis would be the most suitable methodology.

The returned survey questionnaires were coded and analysed using the Statistical Program for Social Sciences, SPSS / PC+. This enabled the author to use the extensive facilities of the package for both data analysis and interpretation.

Not every question in the questionnaire was answered by each respondent, and the numbers of replies tabulated for statistical presentation in Chapter 4 therefore vary.

The original value given for lease contracts and for the leased assets for Questions 19, 26, 27 and 34(c) was in Turkish Lira. This was then converted into US dollars. The UTFT's foreign exchange rate figures

(UTFT, February, 1993), based on the monthly average rate, were used for converting into US dollars.

Responses to the open-ended questions (Q39, Q40) were translated into English, compiled, and results were classified in different categories.

Conclusions and comments derived are based on the analysis and interpretation of the data from the questionnaire, and other data given voluntarily with the questionnaire or supplied later.

3.4 LESSEES' QUESTIONNAIRE

The lessees' questionnaire was designed and distributed to obtain specific information about leasing practices in Turkey from the lessees' and potential lessees' point of view. This section discusses the design of the lessees' postal questionnaire and the selection of the sample of companies in Turkey to which the questionnaire was sent.

3.4.1 Questionnaire development

The lessees' questionnaire was also initially designed on the basis of the leasing literature and previous empirical studies previously carried out in the USA and the UK. Similar to the lessors' questionnaire, before the final format was designed, various drafts of the questionnaire were produced, then modified and adapted to the Turkish leasing industry after discussion with the researcher's adviser.

The questionnaire, initially prepared in English, was then translated into Turkish. The consistency of the Turkish version was again checked by the same Turkish-speaking Ph.D students as before.

The broad objectives of the lessees' questionnaire were to identify the behaviour of companies with respect to leasing, to try to understand why companies lease, and to present a general overview of leasing practice.

The lessees' postal questionnaire was mainly designed to achieve the following specific objectives:

1. To identify the policy and attitudes of lessees and potential lessees towards leasing in Turkey.
2. To identify the type and volume of leased assets during the period 1987-1992, and factors influencing lessees' and potential lessees' decisions to lease.
3. To identify the relationship between leasing companies and lessees/potential lessees concerning leasing transactions.

In order to facilitate the answering of the questionnaire, the questions were arranged in a way that followed the question flow and categorisation, as in Appendix B. The questionnaire was divided into the following areas:

1. *Nature of the companies*: Included the type of company (Q1), and its industry (Q2), number of employees (Q3), and tax position of company for the years 1987-1992 (Q4). The main purpose was to identify the entity of the companies.

2. *Perceptions and attitudes towards leasing*: Identified management's attitude towards leasing (Q5), how companies regard a decision to lease (Q6), how companies are made aware of leasing (Q7), and how companies decide to choose a lessor (Q8).

3. *Acquired assets and leasing activities*: Included value of assets acquired in 1987-1992 (Q9), the number and value of lease contracts (Q10) and type of assets leased (Q11) in 1987-1992, type of assets leased in 1993 (Q24), and total lease obligation of companies (Q27).

4. *Lease evaluation and effect of taxes*: Presented the effect of the VAT rate increase in 1989 on leasing policy (Q20), and lease evaluation methods (Q17 and Q18).

5 *Motivation for leasing*: Asked for the reasons for and effects of motivation on the lessees' decision to lease or not to lease. Included the impact of leasing on borrowing capacity (Q13), factors affecting leasing (Q23) and not leasing (Q26), strategic reasons for leasing (Q21 and Q22), cheapness of leasing (Q19), and determination of optimal lease level (Q25).

6 *Accounting records*: Included recording of leased assets in companies' balance sheet (Q14), and how companies show the lease payments in the profit and loss account (Q16), and value of the capitalised leased assets (Q15).

Question 12 requested details of the criteria which the company used to assess management performance and general business activity.

The last question, Q28, was designed as open-ended for respondents to discuss any leasing-related problems they had encountered and comment on matters concerning their leasing practice not addressed in the questionnaire.

3.4.2 Population and sampling criteria

An attempt was made to obtain information concerning leasing from a range of companies, including:

- size of company,
- type of industry,
- sector type, and
- geographical location of company.

In order to reach as many types of company as possible, a sample of 250 companies for the lessees' survey were selected from various sources. These are:

- The top five hundred companies in Turkey (Istanbul Chamber of Industry 1990).
- Different regional publications of chambers of trade and industry of Turkey.
- State Planning Organisation of Turkey.
- Leasing companies in Turkey.
- The Banks Association of Turkey.

A few more companies were also identified independently from sources such as newspapers and journals and were included in the survey.

The sample was selected on the basis of the following criteria:

- Company head office addresses could be identified.
- Type of industry and sector type could also be identified by sources.

In addition to these, the size of company was also a criterion for selection of the sample companies to provide a spread of company size in the sample representative of the actual spread for all companies in Turkey.

Standard survey techniques were employed in an effort to achieve a reasonable response rate, as described in Section 5.3.2. The questionnaire was again addressed to the managing directors in the total sample of 250 companies. The recipients were asked to forward the questionnaire to the most appropriate person in the company if they were not able to answer it themselves. The replies make it evident that this is what happened (see Section 5.3).

As can be seen in Table 3.1, several basic industries were considered to be of potential interest, such as manufacturing, service firms, transport and communication companies (for distribution of sample companies by region and by sector type, see Section 5.2 and 5.3, respectively).

The questionnaire was distributed during May to August 1993, together with two covering letters, one from the researcher's academic adviser and another from the researcher (in Turkish) describing the objectives of the research project, structure of the questionnaire, and the method of response requested.

Following the completion of the procedure detailed above, within three months a total of 65 replies had been received, a response rate of 26% (the response rate does not include the questionnaires returned as undelivered, numbering 12).

Of the 65 returned questionnaires, 57 (22.8%) were suitable for analysis, the remaining 8 replies were rejected as they were returned uncompleted from companies which claimed that they had never contracted or had no future intention of contracting any leasing agreement.

22.8% (57) useful replies is a reasonable response rate when compared with figures of other questionnaires for similar studies in the literature. Anderson and Martin (1977) achieved 31.5% (63/200) response rate in their survey on lease vs. purchase decision practices in the USA. O'Brien and Nunnally (1983) also achieved 37% (72/195) rate in their survey of corporate leasing analysis in USA. In the UK, 24.1% (241/1000) was achieved by Hubbard (1980) in his study of finance leasing, and a 27.6% (273/988) response rate by Drury and Braund (1990) in their study of financial leasing theory and practice for the UK.

In addition, extra useful information was received from lessees, too. These included details of lease agreement procedures, copies of leasing agreements and accounting records of actual leased assets.

Table 3.1

Business type of companies

Business type	Companies surveyed		Companies responded	
	Number	%	Number	%
Manufacturing	134	53.6	43	75.5
Transport & communication	29	11.6	4	7.0
Finance & banking & insurance	13	5.2	2	3.5
Distribution & service	74	29.6	8	14.0
Total	250	100%	57	100%

Note: The response rate includes only suitable replies.

3.4.3 Analysis and presentation of data

Analysis and interpretation of the data for the lessees' questionnaire was also carried out mainly with the use of descriptive statistics.

The returned survey questionnaires were also coded and analysed by using the Statistical Program for Social Sciences, SPSS for MS WINDOWS version 6.

Again, not every question in the questionnaire was answered by each respondent, and the numbers of replies tabulated for statistical presentation in Chapter 5 therefore vary.

Many concepts may be used to define the size of a business. These include number of employees, sales turnover, total asset value, and capital employed.

According to the 1981 Company Act (UK), if a company satisfies any of two or more following criteria it can be treated as a small or a medium-sized company for accounting purposes.

1. Average number of employees between 50 and 250 on a weekly basis,
2. Amount of turnover between £2 and £8 million,
3. Total asset value between £0.975 and £3.9 million.

The Bolton Committee (Curran, 1986) decided to use a different statistical definition for different sectors of the economy, for example 200 employees or less in manufacturing, 25 employees for construction and mining were given for a small company definition. This resulted, for a small-sized company, in a definition of 100 employees or less for some sectors but as high as 500 employees in others. In the USA, a business employing 500 or less was defined as a small business.

Ganguly and Bannack (1985) reported that there is no universal definition which is the most suitable for all purposes: "whatever the definition chosen it will therefore, to some extent, be unsatisfactory for some uses. The Department of Trade has thus decided not to go for a single definition but to adopt a flexible attitude which allows each case to be looked at on its merit."

In this study, for the purpose of analysis, as shown in Table 5.3, the 57 responding companies in the sample were classified for size by the number of employees into one of the three following classes:

- Small → up to 99
- Medium → from 100 to 999
- Large → 1000 and over employees.

The original value given for acquired assets, and lease contracts, and for the lease obligation value for Questions 9, 10 and 27 was in Turkish Lira. This was then converted into US dollars (using the same calculation as for the lessors' questionnaire).

Responses to the open-ended question (Q28) were translated into English, compiled, and results were again classified into categories.

CHAPTER FOUR

Results and analysis of lessors' questionnaire

CHAPTER FOUR

RESULTS AND ANALYSIS OF LESSORS' QUESTIONNAIRE

4.1 INTRODUCTION

This chapter contains the presentation and analysis of the data provided by the lessors' survey questionnaire (see Appendix A).

It is generally said that if lessors specialise in serving a particular section of the leasing market, competition will be less severe than if they were to compete in all areas of industry. Accordingly, several variables which are associated with the lessors are examined for possible classifications into non-competition groups. These possible variables of leasing market classification include lease size, types of equipment, customer served, lessee location of assets, and the risks of business contracted.

4.2 RESPONSE RATE

The total responses for the survey carried out for the leasing companies in Turkey for period of six years between 1987 and 1992 are summarised in Table 4.1 and Figure 4.1

Table 4.1

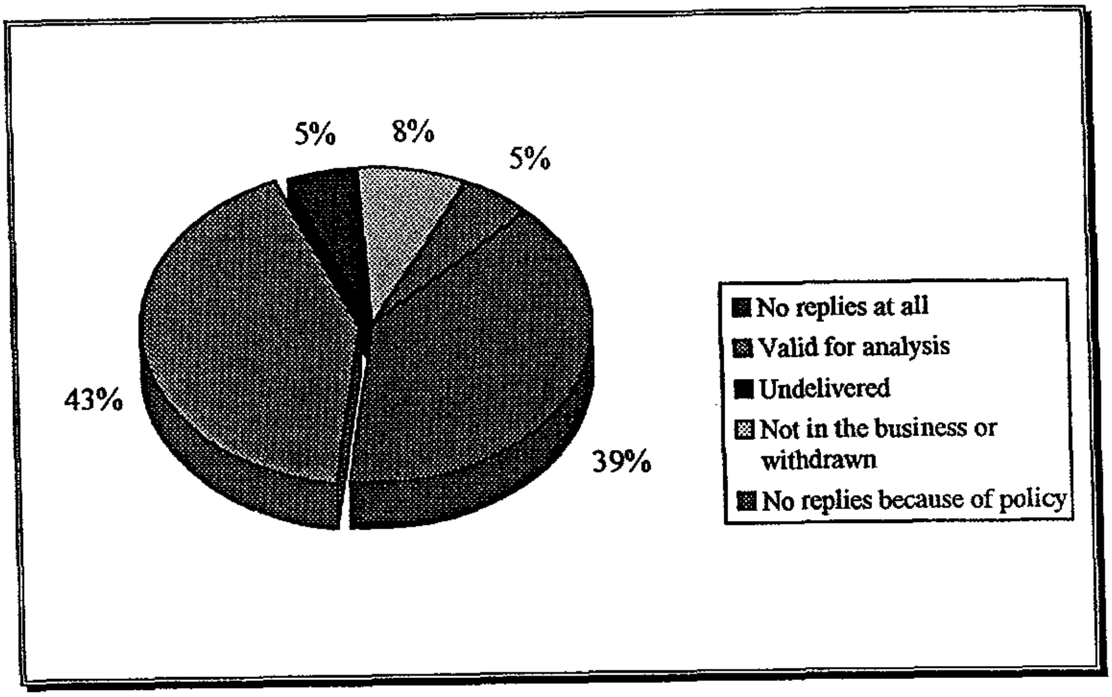
Response rate of lessors' postal questionnaire

Total sample size	**38**
Number of questionnaires returned undelivered	**2**
Number of questionnaires returned not completed because of company policy	**2**
Number of questionnaires returned not completed because of withdrawal or not being in leasing business	**3**
Total number of questionnaires usable for analysis	**16**
Response rate for valid replies	**42.1%**

Within the time allowed, of the original 38 questionnaires, replies were received from 21 leasing companies (does not include the two questionnaires returned as undelivered), of which, however, only 16 were valid for analysis. Although the size of the sample in the survey looks small, it covers about 42 % of all lessors active in Turkey during the period of the survey.

Figure 4.1

Response rate of lessors' postal questionnaire



4.3 SIGNIFICANCE OF RESPONSE RATE

Besides the 55.3% survey response rate, the sample also represents a significant percentage of total leasing transactions in the market. The percentage of sample data collected by the survey to cumulative total leasing business transacted by all leasing companies in Turkey in the period 1987-1992 is given in Table 4.2.

Table 4.2

Significance of survey sample to total leasing business (1987-1992)

	1987	1988	1989	1990	1991	1992	Total
Number of lease contracts in total	177	279	2384	3300	2195	2989	11324
Number of lease contracts in the sample	155	53	1053	2147	830	1671	5909
Total/sample(%)	87.6	19.0	44.2	65.1	37.8	55.9	52.2
Contracts value in total ($US bn)	9.1	67.8	265.6	415.1	401.2	521.7	1680.5
Contracts value in the sample	0.7	2.7	42.5	178.9	143.2	346.9	715
Total/sample(%)	7.7	4.0	16.0	43.1	35.7	66.5	42.5

In terms of number of leases contracts the sample covers over 52 % of the total leasing, in terms of value the sample covers about 42% of all leasing business volume since its commencement in Turkey.

As can be seen in Table 4.3, over 50 % of the 21 questionnaire respondents were managing directors of their leasing companies, about 24 % were deputy managing directors, about 10 % were project and planning directors, and approximately 10 % were marketing and credit and investment directors.

Table 4.3

Classification of respondents according to position in the company

Positions	Number of responses	Percentage
Managing director	12	57.1
Deputy managing director	5	23.8
Project and planning director	2	9.5
Marketing director	1	4.8
Credit and investment director	1	4.8
Total	21	100

4.4 NATURE OF SAMPLE COMPANIES

Five of the leasing companies, from the sixteen usable survey respondents, started their leasing business in 1992, two started in 1991, four were established in 1990, three in 1989, and the other two started in 1988 and 1987.

From the point of view of the nature of share of capital structure the companies in the sample can be described as follows: eight of the sixteen respondents were a subsidiary of either a commercial or development and investment Turkish bank, four lessors were joint-venture with a Turkish financial institution or a bank, three belonged to a Turkish bank and a Turkish manufacturing company together. Only one of the leasing companies in the sample had no financial relation with another financial institution; this may be called an independent leasing company (Table 4.5).

Table 4.4

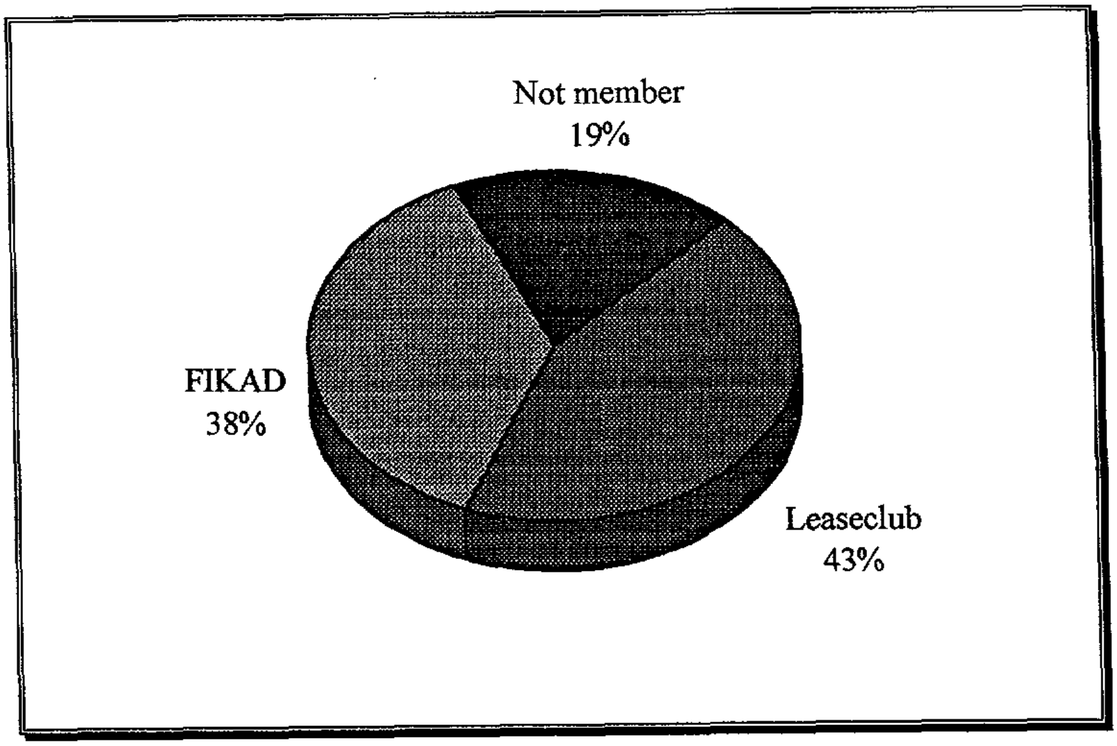
Entity of leasing companies

	Total number	%
Subsidiary of Turkish bank	8	50.0
Subsidiary of joint-venture financial institution	4	25.0
Subsidiary of Turkish bank and manufacturing company	3	18.8
Independent leasing company	1	6.2
Total	16	100

Figure 4.2 categorises the respondents either as a member of one of two leasing association, namely Leaseclub or FIKAD, or member of neither of these organisations. The figure shows that approximately 81 % of the sample leasing companies were members of either one of the leasing associations. Of these, the majority were members of Leaseclub (43.7 %). About 19 % of the respondents were members of neither of the existing lease associations in Turkey.

Figure 4.2

Membership of leasing associations



Leasing companies established according to Turkish Financial Leasing Law cannot provide any business other than leasing transactions, with the exception of PFI and D&IB lessors. All lessors in both these groups indicated individually that, since they started doing leasing business, their yearly total leasing transactions contributed less than 25 % of their yearly cumulative total financial and other service business. Two of the BA sample companies also stated that in addition to leasing business they were acting as financial adviser to their clients, but the contribution of this service to the total business was very small.

For the purpose of analysis, the leasing companies were categorised according to the nature of their organisations such as PFIs, D&IBs and BA&POLCs. Because of similar establishment, auditing, and transactions of lessors in the group, POLCs and BA were categorised as BA&POLCs in one group. For further analysis respondents were also divided into three sub-groups A, B and C, as given in Tables 4.5 and 4.6.

Table 4.5

Classification of lease contracts by average size

Classification index	Average lease size
A	Less than $US 250,000
B	$US 250,000 - 500,000
C	More than $US 500,000

Table 4.6

Number of lessors by average size of lease (1987-1992)

Classification	Type of lessors (number)			Total
	PFIs	D&IBs	BA&POLCs	
A	1	1	5	7
B	-	1	3	4
C	1	3	1	5
Total	2	5	9	16

4.5 SIZE OF LEASES

The cumulative total number of leasing transactions executed in Turkey up to the end of 1992 were 11324, with a total value of about $US 1.7 billion (see Table 2.2.1).

Individual items of equipment leased between 1987 and 1992 by the sample companies in the survey, described earlier, ranged in value from $US 580 to $US 23.5 million. The average value of leases contracted in this period was $US 120,945. In terms of numbers, over 90 % of the total value of leases in the survey were valued at less than $US 250,000. The combined total value of these leases was 68% of the total value of all leases (see Tables 4.7 and 4.8).

Table 4.7

Number of leases contracted (1987-1992)

Classification	Type of lessors			All lessors
	PFIs	D&IBs	BA&POLCs	
A	98.8	0.7	91.6	92.0
B	-	10.3	8.2	5.3
C	1.2	89.0	0.2	2.7
Total	100%	100%	100%	100%

Table 4.8

Value of leases contracted (1987-1992)

	Type of lessors			
Classification	**PFIs**	**D&IBs**	**BA&POLCs**	**All lessors**
A	92.2	-	72.1	67.7
B	-	6.8	26.8	15.2
C	7.8	93.2	1.1	17.1
Total	100%	100%	100%	100%

There is a substantial difference in average values of leases between companies in the survey sample. Over 30 % of companies in the sample provided financial leasing facilities with an average contract value of less than $US 100,000. Certain lessors specialised in large value ($US 13.5 million) lease transactions while others specialised in leases of less than $US 25,000. The differences in lease values accepted by different organisations depended much on the nature of the organisations themselves. For instance, the average lease value of development and investment banks was approximately $US 750,000, whereas the average lease value contracted by PFIs and BA&POLCs was just over $US 100,000.

Analysis of replies relating to size of lease as given by respondents is summarised in Table 4.9

Table 4.9

Size of leases by the type of lessors (1987-1992)

	PFIs	D&IBs	BA & POLCs	Total
Total value of leases $US (000)	231571	108680	374411	714662
Percentage	32.4%	15.2%	52.8%	100 %
Number of contracts	2190	145	3574	5909
Percentage	37.1%	2.5%	60.4%	100%
Average lease value $US (000)	105.7	749.5	104.8	120.9

4.6 TYPES OF EQUIPMENT LEASED

Lessors were asked in the questionnaire to give the main industrial areas relating to their leasing activities as percentages of total annual leasing turnover. For the period 1987-1992 eleven such areas can be identified. These are: manufacturing plants and machinery, textile machines, computer and office equipment, medical and dental equipment, private and commercial vehicles, heavy vehicle and construction equipment, aircraft, marine transportation, hotels and restaurants, printing and telecommunication, and real estate. This classification was provided by fifteen lessors (one lessor in the D&IB group stated that it did not classify its leasing business). The most important equipment type leased was private and commercial vehicles which accounted on average for over 26 % of new leases negotiated between 1987 and 1992. Although, as can be seen in Table

4.10, automotive was the originally largest component of total leasing, in 1991, it has since then progressively begun to lose its importance. Its share of the total dramatically declined to 8 % in 1991 from 48 % in 1990. This is because, as described in Section 2.2.3.1, until the middle of 1991, there were very significant advantages in leasing non-commercial vehicles as VAT was only 10 % as compared with 15 % for purchase. In July 1991, VAT on car leases was increased to the level on car purchase and this had a significant impact on the volume of contracted car leases.

Other important types of equipment leased are manufacturing plant and machinery which, together with general industrial equipment with the exception of textile machinery, accounted for approximately 22 %, and computer and office equipment, which accounted on average for about 21 % of new leases contracted between 1987 and 1992. Other main types of equipment leased are textile machinery, construction equipment, medical equipment, and tourist assets such as hotels and restaurants.

During 1987 to 1992, the proportion of leased computer and office equipment and automotive declined. In contrast, the proportion of leased manufacturing plant and machinery, medical appliances and construction equipment constantly increased and these sectors are still the growing sectors of the market at present. The least important category was real estate due to a few tax disadvantages. The buyer and seller are each obliged to pay 4 % up-front tax on the price of the real estate, making it in total 8 %. Furthermore, 2 % depreciation allowance did not make the real estate transaction attractive due to lack of tax incentive.

Table 4.10

Type of equipment leased by years (1987-1992)

Equipment type	Years						Average
	1987	1988	1989	1990	1991	1992	
Manufacturing plant and machinery	9.7	45.3	6.1	13.6	25.6	31.5	22.0
Textile machinery	21.9	20.5	0.2	1.6	18.3	6.8	11.5
Computer and office equipment	42.2	7.5	43.5	12.4	15.3	8.7	21.6
Medical equipment	-	3.5	0.1	2.4	1.9	12.6	3.4
Automotive	26.2	23.2	42.2	48.6	8.8	8.1	26.2
Aircraft	-	-	-	-	6.1	2.0	1.4
Shipping	-	-	-	4.2	2.2	3.1	1.5
Heavy vehicle & construction equip.	-	-	1.1	6.7	14.8	15.2	6.3
Hotel and restaurant & Tourism	-	-	5.0	7.8	5.2	8.9	4.5
Real estate	-	-	1.0	1.4	1.0	1.7	0.9
Printing and telecommunication	-	-	0.8	1.3	0.8	1.4	0.7
Total	100%	100%	100%	100%	100%	100%	100%

Types of equipment leased for period 1987-1992 by each lessor group, are shown in Table 4.11.

Table 4.11

Type of equipment leased (1987-1992)

Equipment type	Type of lessors		
	PFIs	D&IBs	BA&POLCs
Manufacturing plant and machinery	5.8	29.1	22.4
Textile machinery	5.9	8.5	10.0
Computer and office equipment	2.8	27.2	25.0
Medical equipment	11.4	1.2	3.6
Automotive	54.1	1.4	22.3
Aircraft	14.1	-	0.1
Shipping	0.1	8.7	0.2
Heavy vehicle & construction equip.	3.0	1.2	12.4
Hotel and restaurant & Tourism	2.1	16.8	2.9
Real estate	0.4	3.1	0.6
Printing and telecommunication	0.3	2.8	0.5
Total	100 %	100 %	100 %

The results show that PFIs had a major interest in automotive leasing. During this period, PFIs contracted more than 50 % of the total number of leases written for this sector. Bank-affiliated and private-owned leasing companies wrote almost a quarter of the total, whereas D&IBs had less than 2 % interest.

Computer and office equipment leasing attracted almost equally the D&IBs and BA&POLCs. BA&POLCs had a major interest of 25 % of the total, followed by D&IBs' second ranking interest of 27 %. PFIs had a very insignificant interest in this sector.

The manufacturing plant and machinery leasing sector was another equally attractive sector for the lessors. D&IBs had a major interest totalling 29% and BA&POLCs' interest amounted to 22 %.

The leases for the aircraft and aerospace sector were contracted by mainly PFIs. This sector was the second ranking interest for PFIs, amounting to 14%, following their lead in the automotive sector. The other types of lessors, D&IBs and BA&POLCs, had virtually no involvement in this sector. (For the average size of leases, see Table 4.12)

Table 4.12

Average size of leases (1987-1992)

Equipment type	Average lease size classes		
	A	B	C
Manufacturing plant and machinery	19.9	16.2	28.0
Textile machinery	9.7	57.8	-
Computer and office equipment	20.2	4.2	27.2
Medical equipment	1.6	-	12.3
Automotive	31.3	5.2	12.6
Aircraft	2.5	-	-
Shipping	0.3	4.7	4.5
Heavy vehicle & construction equip.	10.3	7.8	-
Hotel and restaurant & Tourism	3.1	3.0	11.4
Real estate	0.6	0.6	2.1
Printing and telecommunication	0.5	0.5	1.9
Total	100%	100%	100%

An important aspect of the leasing market structure is the extent to which companies specialise in supplying certain types of equipment. If lessors specialise in serving a particular section of the leasing market, competition will be less severe than if they were to compete in all areas of industry. The extent of specialisation was investigated by analysing the number of equipment categories covered by individual lessors, as well as the importance of the main type of equipment supplied in each lessor's total leasing operations and the extent to which activity in particular equipment classes is dominated by one firm (see Tables 4.13 and 4.14). The fifteen respondents operated on average in approximately five equipment categories from a possible maximum of eleven and their most important areas of operation accounted for over half (51.8%) of total activity.

Table 4.13

Degree of specialisation of equipment by type of lessor (1987-1992)

Index of specialisation	Type of lessors			All Lessors
	PFIs	D&IBs	BA&POLCs	
Average number of equipment types	6.5	3.8	5.8	5.3
Importance of main type in total activity	50.8%	73.6%	42.4%	51.8%
Percentage of lessors with 50 % or more of activity in main type	50.0%	75.0%	22.2%	40.0%

Two-fifths of the lessors had 50 % or more of their activity in a single category of equipment. However, in general, leasing companies do not specialise narrowly in particular commodity classes. Nevertheless, the analysis given in Table 4.13 shows that there is some tendency for firms to concentrate activity in certain areas.

Important differences emerge when lessors are distinguished by type. A tendency to specialise in equipment is more apparent for companies in the D&IBs group as compared with others. The average of equipment types for this group was about four, which is to be compared with an average of 73.6%, representing the importance of the main type of total activity. As shown in Table 4.11, D&IBs specialised almost equally in manufacturing plant & machinery and computer and office equipment leasing types. Hotel and tourism was D&IBs' third major interest.

PFIs specialised in automotive leasing. They also had the lead in aircraft and medical equipment types. This group of lessors was the second ranking in terms of specialisation.

BA&POLCs had a variety of interest in different types of equipment leasing. Whilst they had the market lead in heavy vehicle and construction and textile machinery, their interest included manufacturing plant and machinery, computer and office equipment, and automotive. The average number of equipment types for this group was about six, which is to be compared with 22.2% having 50% or more of activity in the main type, hence showing the least specialisation. Whilst the automotive market was dominated by the two groups PFIs and BA&POLCs, medical equipment was dominated by PFIs and heavy vehicle and construction equipment by BA&POLCs.

Tables 4.14 shows that specialisation is more likely to apply for lessors of large leases than for lessors of medium and small leases.

Table 4.14

Degree of specialisation of equipment by average lease size (1987-1992)

Index of specialisation	Class			All lessors
	A	B	C	
Average number of equipment types	5.7	6.8	3.3	5.3
Importance of main type in total activity	50.9%	33.7%	71.3%	51.8%
Percentage of lessors with 50 % or more of activity in main type	42.9%	25.0%	50.0%	40.0%

As can be seen in Table 4.15, manufacturing plant and machinery were the most competed types of operation, conducted by 86.7 % of total firms in the sample. Computer and office equipment and commercial and private vehicles were leased by twelve respondents from a possible maximum of fifteen. In contrast, only two lessors operated in the aerospace market with a share of 96.1 % and 3.9 % of groups PFIs and BA&POLCs, respectively.

Table 4.15

Type of equipment competed in the market (1987-1992)

Equipment type	Type of lessors						All lessors	
	PFIs		D&IBs		BA & POLCs			
	no	%	no	%	no	%	no	%
Manufacturing plant and machinery	2	100	3	75.0	8	88.9	13	86.7
Textile machinery	1	50.0	1	25.0	5	55.6	7	46.7
Computer and office equipment	1	50.0	2	50.0	9	100	12	80.0
Medical equipment	2	100	1	25.0	3	33.3	6	40.0
Automotive	2	100	2	50.0	9	100	12	80.0
Aircraft	1	50.0	-	-	1	11.1	2	13.3
Shipping	1	50.0	2	50.0	2	22.2	5	33.3
Heavy vehicle & construction equip.	1	50.0	1	25.0	8	88.9	10	66.7
Hotel and restaurant & Tourism	1	50.0	2	50	3	33.3	6	40.0
Real estate	1	50.0	1	25.0	3	33.3	5	33.3
Printing and telecommunication	1	50.0	1	25.0	2	22.2	4	26.7

4.7 DEGREE OF RISK

Another variable which can be used to classify the lessors is the degree of the risk they are willing to take. Almost all forms of activity involve some element of risk, and the business of asset financing is no exception. For the purpose of the definition of risk within the industry, the word *risk* will be taken to refer to the probability of failure or making a particular loss on a leasing agreement.

Possibility of default by the lessees, difficulties of repossession and resale of equipment, changes in interest and exchange rates affecting the cost of funds or alterations in laws are the main risk factors which might influence the leasing business.

The assessment of risk can not be considered to be a precise science. The analyst, who interprets the financial information, will be concerned with the past performance of the business in an attempt to predict future behaviour, and with the general economic trends.

As Tomkins et al. (1979) illustrate, there are several ways to reduce the degree of lessors' risk. For instance,

1. by refusing certain types of business,
2. by diversifying across types of equipment,
3. by limiting the proportion of assets tied up in a single lease,
4. by introducing interest variation clauses into lease agreements, and
5. by screening the credit-worthiness of clients very carefully.

There are provisions in the Turkish Finance Leasing Law that reduce the degree of the lessors' risk as well as the lessees'. The lessees are obliged to use goods with care, and also they are responsible for maintaining and protecting the goods and must bear the cost of any kind of maintenance and repair. If the assets are damaged because of the lessee's fault, the lessor may demand compensation and may be able to terminate the contract.

Under the Financial Leasing Law the leased asset must be insured for the term of contract and the insurance premiums are to be paid by the lessee. If the lessee defaults on lease payments, the lessor has the right to terminate the contract. The lessor must grant thirty days' grace before abolishing the contract. This grace period is sixty days if the contract gives a purchase option to the lessee. If the contract is terminated by the lessor due to the default of the lessee, the claim for immediate payment of all the rental outstanding, as well as the return of the equipment, stands out as a penalty.

Also, the Financial Leasing Law protects the lessor if the lessee becomes bankrupt or the lessee's creditors attach bailiffs to the leased equipment. The lessee is also similarly protected from the lessor's creditors and insolvency.

If for any reason the contract is terminated, the leased assets are required to be returned to the lessor, unless the lessee exercises the option to purchase the asset or automatically obtain ownership of the goods upon the expiration of the term.

Lessors may introduce interest rate variation clauses into lease agreements, the maximum interest rate allowed is not limited. Furthermore, there is no specific profit margin on the total cost which includes depreciation and expenses.

Lessors, indeed, are very cautious in screening client credit-worthiness. As can be seen in Figure 4.3, lease offers are generally decided by a different committee of lessors if the lease value proposed by a lessee is over a certain amount. Leasing companies seek from the lessee at least the last three months' financial statements which should be approved by a public notary, submission of more proxy by the lessee, and various interest clauses added to the agreement as there is no limitation of interest and profit margin on cost. All these may reduce the risk of lessors.

Figure 4.3

A lease agreement process

MD: marketing department
MB: managerial board
CC: credit committee
OD: operation department
AD: accounting department

Lessee applies with project and payment proposal to MD

↓

MD with lessee's proposal suggests different lease payment alternatives to either MB (if project over certain value-such as TL 2 billion-) or CC

↓

1. If MB or CC rejects the project, inform lessee, with reason.

↓

2. If project accepted with lessee's payment proposal, inform lessee.

3. If project can be accepted with one of MD's payment alternatives, inform lessee with new proposal.

↓

1. If new proposal (3) rejected by lessee, MD informs MB or CC with reason given by lessee.

↓

2. If lessee agrees with new proposal or proposal is accepted

↓

The following are asked from lessee by MD

- pro-forma invoice of equipment.
- features of equipment.
- at least last three months' financial statements approved by tax authority.
- brief history of company.

↓

Provided document examined by MB or CC.

↓

According to degree of risk of project, proxy and collateral are asked from lessee via MD.

↓

If lessee rejects, MD informs MB or CC.

If asked for proxy and collateral accepted by lessee

↓

(OD) Lease contract signed and approved by public notary

↓

(OD) Proxy and collateral taken from lessee

↓

(OD) Equipment ordered from manufacturer or dealer

↓

(AD) Payment for equipment to manufacturer or dealer

↓

(AD) Equipment insured

↓

(OD) Order to deliver equipment to lessee from manufacturer or dealer

↓

(AD) Receive delivery documents from both manufacturer and lessee

↓

(AD) Record equipment as asset in company balance sheet

↓

(OD) Report lease contract to UTFT

↓

(AD) Receive lease payments from lessee

↓

(AD) At end of lease period transfer ownership of equipment to lessee at nominal value or with value agreed on lease contract

The difficulty arises when borrowing medium-term funds; this also causes problems with match-funding, that is, matching the funds maturely with the length of the lease term. Also, lessors have to deal with high and widely fluctuating interest rates. Alternatively, lessors can borrow from abroad or issue commercial papers and corporate bonds, but these methods are governed by strict limitation and the large daily adjustments of Turkish Lira against foreign currency, which increases the financial risks (see Appendix F, exchange rate for the period 1985-1994).

4.8 CUSTOMER SECTOR

Another variable which may be used to classify lessors is the sector classification of the leases they give. Table 4.16 shows the extent to which lessees of the sample companies for the questionnaire were drawn from public, private sector or mixed (public / private) sectors in Turkey between 1987 and 1992. The private sector was dominant and accounted for about 98 % of the value of leases written in the business of all the leasing companies in the period 1987-1992. Out of the total population sample of 16 lessors, ten of them wholly and exclusively did at least 78 % of their business for the private sector. Only six of the lessors negotiated leasing contracts with the public sector, accounting for less than 2 % of the value of all leases negotiated during the same period. None of the lessors in the sample had conducted leasing contracts with mixed-sector companies.

None of the lessors in the D&IBs group in the sample had leasing contracts with the public sector. Of the six lessors who signed leasing contracts with public sector companies, five were in the BA&POLCs group and one in the PFIs group. Of the nine lessors constituting the BA&POLCs group, five conducted business with public sector companies. However, the volume of this public sector business constitutes only 1.6 % of the total business of the BA&POLCs group

Table 4.16

Sector of customers (1987-1992)

Sectors	PFIs	D&IBs	BA&POLCs	All lessors
Private sector	91.0	100	98.4	98.4
Public sector	9.0	-	1.6	1.6
Mixed sector	-	-	-	-
Total	100%	100%	100%	100%

Leasing is becoming more popular in acquiring assets in the private sector. It appears that private sector business will account for virtually all the leases business in the future. In the 1994 Budget, Mrs. Çiller's Government proposed to cut public expenditure and restrict capital outlays in order to reduce the budget deficit (Zaman, 21 November, 1993). It was announced that acquiring new assets by the public sector companies, both by buying or leasing, was to be frozen. As a result, all leasing business in the public sector will cease if the government policies on acquiring assets remain.

4.9 REGIONAL PATTERN OF LEASES

Fourteen out of the total sample of sixteen lessors provided geographical information about their lessees. However, these fourteen accounted for only 66% of the total leasing business in Turkey; accordingly, geographical information is not available for approximately 34 % of the business. The equipment type is categorised according to the location of the lessee's head office which is not necessarily where the equipment is used because this information was not provided.

Table 4.17 shows that 100 % of the leasing equipment covered in the sample period 1987-1992 was within the national boundaries of Turkey, distributed in each of the seven regions (see Figure 4.4). The most important area appears to be Marmara, which is also the most developed region in Turkey and where 88 % of the sample lessors' head offices are located. The smallest proportion of leases is with companies located in East and South-East Anatolia, which accounted for only 0.6%.

Table 4.17

Regional allocation of leased assets (1987-1992)

Regions	Lessor Type			All lessors
	PFIs	D&IBs	BA & POLCs	
Marmara	36.3	94.4	81.5	81.4
Aegean	2.4	5.3	8.0	7.1
Central Anatolia	58.4	-	6.0	7.3
Mediterranean	-	0.3	3.1	2.7
Black Sea	2.9	-	0.7	0.9
East Anatolia	-	-	0.4	0.3
South-East Anatolia	-	-	0.3	0.3
Other	-	-	-	-
Total	100%	100%	100%	100%

The lessors in group BA&POLCs generally regarded themselves as potentially supplying to the whole of the national market rather than specialising in a particular region within Turkey (see Table 4.17a).

Table 4.17a

Regional allocation of leased assets (1987-1992)

Regions	Lessor Type			Total
	PFIs	D&IBs	BA & POLCs	
Marmara	17.1	44.5	38.4	100%
Aegean	15.3	33.7	51.0	100%
Central Anatolia	90.7	-	9.3	100%
Mediterranean	-	8.8	91.2	100%
Black Sea	80.6	-	19.4	100%
East Anatolia	-	-	100	100%
South-East Anatolia	-	-	100	100%
Other	-	-	-	-

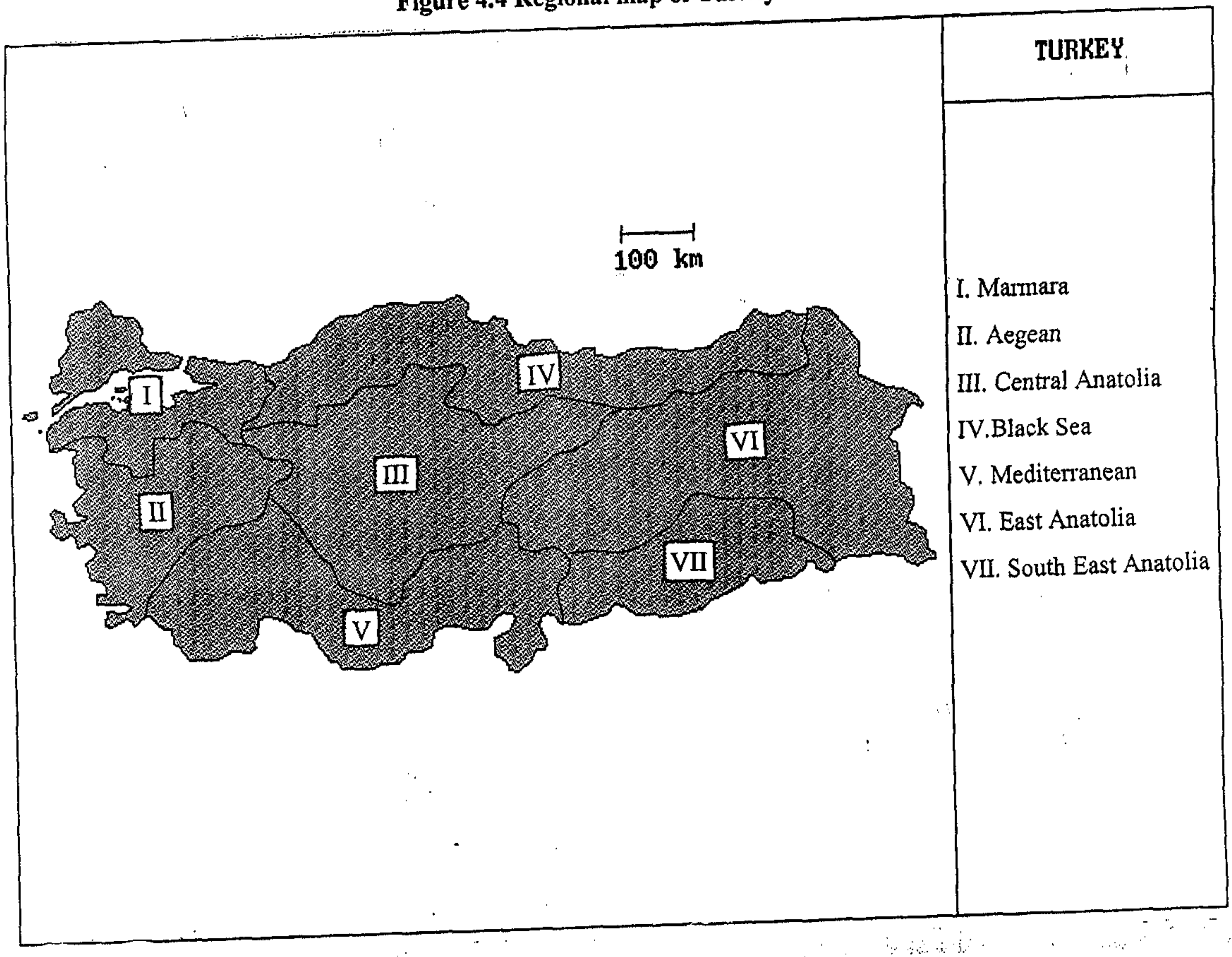
As can be seen in Table 4.18, the location of assets was not a first condition in the decision to provide leasing finance before entering into a leasing agreement. Lessors generally seek a high rate of return on their investment, thus regional stability, taxation law, regional development grants and tax investment incentives for special industries are a major inducement for leasing business in the regions. Table 4.18 shows that all lessors consider lessees' financial stability as a first requirement before entering into a leasing agreement. Expected economic life of equipment and expected rate of depreciation are the second and third important factors at 50 % and 31 %, respectively.

Table 4.18

Lessors' considerations before entering lease agreement (%)

Considerations	Lessor Type			All lessors
	PFIs	D&IBs	BA & POLCs	
Lessees' financial stability	100	100	100	100
Expected economic life of equipment	50.0	20.0	67.0	50.0
Expected rate of depreciation	-	60.0	22.0	31.3
Location of lessees	-	20.0	44.0	31.3
Others	-	20.0	44.0	31.3

Figure 4.4 Regional map of Turkey



4.10 LEASE DIFFERENTIATION

Lease differentiation can be defined as the extent to which lessees have a specific preference among the choices offered by lessors within the industry. Such differentiation can have significant influence on the competitive relationship between established lessors as well as on the height of barriers faced by new entrants to the market.

In the next section the various aspects of lease differentiation within leasing companies will be analysed.

4.10.1 Origin of new business (lessors' marketing)

Direct contact and marketing by leasing companies to lessees play a major role in obtaining new business in the leasing industry. Usually, lessors are actively pursuing policies to create a niche for themselves in the market. Table 4.19 indicates that over 60 % of all new business in terms of leases resulted from direct personal contact. This is a "cold call" approach, where the lessors' marketing staff and sales team make initial contact with their clients.

Leasing facilities are often made available through a direct sales force rather than through traditional banking links and offices. The table also shows the importance of recommendations of manufacturing companies. This accounted for 18 % of all new leasing transactions. Parent banks and their branches and general advertising also play important roles in obtaining new business, and accounted for approximately 8 % and 6 %, respectively.

Table 4.19

Origin of new business

(In terms of number of contracts)

Origin of business	Lessor Type			All lessors
	PFIs	D&IBs	BA&POLCs	
Direct personal contact including sales team	30.6	74.3	56.1	60.5
General advertising	25.6	-	2.7	5.9
Contact made at conferences & seminars	5.6	5.4	2.0	3.0
Introduced by manufacturers	18.8	-	27.9	17.9
Introduced by other lessees	15.0	1.1	1.1	2.6
Introduced by other lessors	4.4	6.2	0.1	2.6
Parent banks and their branches	-	13.0	10.1	7.5
Total	100%	100%	100%	100%

When analysed from an organisation type point of view, as in Table 4.19, the origins of new business differ. While D&IBs and BA&POLCs rely heavily on companies' direct contact and their sales team, PFIs rely more on direct personal contact, general advertising, recommendations of manufacturers, and their existing customers. Again, PFIs and BA&POLCs obtain a considerable proportion of new leasing business by manufacturer recommendation; on the other hand, D&IBs obtain no business from this source. The table also shows the importance of parent banks and their branches in making initial contact with lessees among the D&IBs' and BA&POLCs' lessors. It should be noted that PFIs themselves are parent companies and they have a few branches all around Turkey.

The lessors were also asked the question whether their sales teams had training in marketing. PFIs, D&IBs, and BA&POLCs replied positively, with an answer of 100 %, 80 % and 78 %, respectively. Again, it can be noted that PFIs (15%) obtain the largest volume of business introduction from existing lessees. This would perhaps indicate that PFIs' lessees are more satisfied with their lessors than the other lessees.

4.10.2 Customer loyalty(repeat business)

The volume of repeat business with lessees gives an indication of the extent of customer satisfaction and loyalty. The indication of customer loyalty, in terms of new lease contracts, over the period 1987 to 1992, is given in Table 4.20. As seen in the table, 81.2 % of the value of all business written by the sample lessors during the same period was with new lessees, whereas only 18.8 % of asset value was repeat business. This suggests that group PFIs and BA&POLCs enjoy customer allegiance, although much new business is contracted with new customers. However, there are substantial variations between companies within these categories which may be explained by the date when these companies were established and their relative growth rates.

It should be noted that customers in the first year of the leasing companies' business were not considered, because all leasing companies started with 100 % of new customers (with two exceptions of an investment bank and a BA which started their first-year leasing business with their parent company customers).

A summary of responses to the question are given in Table 4.20. As expected from the reply on the source of new business arising from client recommendation, PFIs again do very well, with 18.8 % of their business from that source, but surprisingly BA&POLCs do even better with 25.3 %. This figure of 25.3 % may be related to the early establishment of one of the leading lessors in the market within this group whilst lessees had few options to choose a suitable one.

On the other hand, all lessors had to turn to new business due to the increase in their share of the market. This is due to the following factors:

1. At the beginning lessees were unfamiliar with lease finances.
2. The minimum contract period was for four years, thus lessees who had already contracted might feel disinclined to sign a new contract until the existing one expired.
3. As every year new lessors entered the leasing market, lessees had more options to choose from, hence the market became more competitive.
4. In 1987 lessors dealt mainly with small value leases, such as cars, computer and office equipment. Gradually, they progressed into leases

for equipment of much greater value. Therefore, the original customers who had small value were leases now less attractive to their lessors.

5. During the period 1987-1992, every year new lessors entered the leasing market with new classes of clients.

Table 4.20

Customer loyalty (1987-1992)

Type of business	Lessor type			All lessors
	PFIs	D&IBs	BA&POLCs	
Repeat business with previous lessees	18.8	7.5	25.3	18.8
Business with new lessees	81.2	92.5	74.7	81.2
Total	100%	100%	100%	100%

4.10.3 Source of finance (lessors' financing)

The regulations for establishing leasing companies, Article 21, states that leasing companies may raise funds on the securities market through issue of corporate bonds, debentures and shares on national and/or foreign markets within the framework of the relevant laws and legislation. Another source of funding is loans, which financial leasing companies receive from banks, insurance companies and other financial institutions. Alternatively, lessors can borrow from abroad or issue debentures and corporate bonds for a two-year term; however, these methods are subjected to strict limitations.

The real difficulty leasing companies are facing is a shortage of available funds, especially finding finance for more than two years. The government's tight monetary policy has pushed up the effective cost of borrowing short-term domestic funds to about 130 % p.a., and with inflation running at about 70 %, borrowing in the domestic market is expensive. The difficulty in borrowing medium-term funds is also causing problems with match-funding for the length of the lease term. Annually, about 60 % of the daily adjustment of Turkish Lira against foreign currency also makes obtaining funds abroad difficult.

The main difference lies between BA&POLCs and PFIs because, unlike PFIs, BA&POLCs can not raise funds directly from the public; PFIs can however through their clients, based on profit-loss sharing accounts, which pay no interest. This enables the PFIs to acquire more funds at a cheaper rate than their competitors. BA&POLCs are subject to 11 % tax on interest for loans they obtain to finance their activities, whilst PFIs and D&IBs are exempt from such tax. Kurmus (1988) points out that in Turkish financial practice a leasing company which is established as a subsidiary of a commercial bank does not have any opportunity to obtain loans from other banks. Therefore, the parent bank has to be the main source of loans for the leasing company. The main sources of capital acquired by the sample lessors are summarised in Table 4.21.

Table 4.21

Source of finance

Source of funds	Lessor type			All lessors
	PFIs	D&IBs	BA&POLCs	
Share capital	9.3	78.4	47.6	56.4
Short-term bank borrowing	-	-	14.9	9.9
Long-term bank borrowing	-	9.1	22.9	12.2
Debentures	-	-	9.9	4.3
Tax allowances	-	-	1.9	0.9
Retained earnings	-	-	2.1	1.0
Sharing profit-loss accounting	90.7	-	-	12.1
Other sources	-	12.5	0.7	3.2
Total	100%	100%	100%	100%

The table clearly reveals that ordinary share capital accounted for a large part of the total financing and is about 56 % of the total raised. This is because most of the lessors started their first year with 100 % equity capital. In the last few years this proportion has progressively dropped, being 66 % in 1988 and about 39 % in 1992 (see Table 4.22). The other important source of financing is bank borrowing, which accounts for about 22 % of the total finance raised. Most of the funds obtained are from banks which are also parent companies.

Because of the structure and nature of lessors and their ability to find sources of finance, it is of interest to analyse the financing by organisation type.

PFIs' leasing business funds mainly come from clients' profit-loss sharing account (90.7 %) and they also rely to a lesser extent on their share capital.

D&IBs mainly depend on their share capital (78.4 %), they issue bonds in the capital market (12.5 %) and they also finance their leasing business with long-term bank borrowing (9.1 %).

As can be seen in Table 21, after equity capital (47.6 %), bank loans are one of the major sources of finance for BA&POLCs' lessors at about 38 %. This is predominantly long-term bank borrowing (22.9 %) which is mostly raised through parent banks. Debenture is also one of the main sources of finance for this group of lessors. Table 4.21 also indicates that BA lessors were benefiting from all kind of sources in order to raise the necessary funds in the capital market.

Probably there is a real difficulty in finding necessary funds for completely independent lessors established according to Financial Leasing Law Number 3226 and having no partnership relation with a financial institution.

Recently, many new lessors, mainly BA , are entering the leasing market. Consequently, the availability of funding is not a very serious barrier to enter the market. There is still enough room for many new lessors. Independent lessors, however, may still find it hard to enter the market due to rigorous funding requirements.

Table 4.22

Source of finance by years (1987-1992)

Source of funds	Years					
	1987	1988	1989	1990	1991	1992
Share capital	100	66.0	45.0	46.8	41.5	39.3
Short-term bank borrowing	-	34.0	3.7	4.2	7.3	10.2
Long-term bank borrowing	-	-	13.3	14.8	19.4	25.5
Debentures	-	-	3.7	9.6	6.3	6.1
Tax allowances	-	-	-	2.2	2.0	0.9
Retained earnings	-	-	0.7	1.8	0.7	2.7
Sharing profit-loss accounting	-	-	33.3	20.0	11.1	8.4
Other sources	-	-	0.3	0.6	11.7	6.9
Total	100%	100%	100%	100%	100%	100%

4.11 REASONS FOR LEASING

When the general business public becomes aware of the advantages of leasing the leasing market should considerably expand.

The relative importance of the variables that enter into the leasing decision vary from company to company and for each type of asset leased. The operating conditions of a particular industry may tend to make leasing more attractive than in other industries.

The main reasons for leasing as perceived by lessors are summarised in Tables 4.23 and 4.24.

Table 4.23

Factors influencing lessees' decision

	Lessor type			All
Factors	**PFIs**	**D&IBs**	**BA&POLCs**	**lessors**
Cost of finance	**5.0**	**4.4**	**4.6**	**4.6**
Fixed payment schedule	**4.0**	**4.0**	**3.8**	**3.9**
Availability of funds	**3.0**	**3.0**	**3.0**	**3.0**
Tax advantage	**3.5**	**2.8**	**2.9**	**2.9**
Financial risk reduction	**2.5**	**2.4**	**2.3**	**2.4**
Size of lessees' total assets to cost of item being leased	**2.0**	**1.8**	**1.8**	**1.9**

**** Maximum score: 80, minimum score: 16***

Respondents were asked to rank the importance of given factors on influencing the lessees' decision on a scale of 1 to 5, 5 being very important and 1 corresponding to minor importance. The values of each factor for each respondent give an aggregate score for that factor on an achievable maximum. The maximum score for each factor is 80 with a maximum of 5. The ranking for each factor was then averaged for the three types of lessors. These averages are given in Table 4.23.

It is seen that ranking between all three sectors is relatively consistent and highly correlated. The two highest ranking, cost of finance and fixed payment schedule, are both placed in the same order by all three sectors. Similarly, financial risk reduction and size of lessees' total assets to cost of item being leased are placed in the same order at the bottom by all three. Availability of funds and tax advantages average aggregates are all close together. However, PFIs have a reverse ranking to the other two sectors which place them in third and fourth place, respectively.

Respondents were also asked to mark the major of given reasons which make leasing more attractive than purchase to the lessor. The responses were analysed in the same manner as factors influencing the lessees' decision. The average rankings for each reason for the three types of lessor are given in Table 4.24.

Table 4.24

Reasons making leasing more attractive than purchase

Reasons	Lessor type			All lessors
	PFIs	D&IBs	BA&POLCs	
Tax benefits to the lessors	1.5	4.4	3.8	3.7
Lower acquired asset prices	4.0	3.6	3.3	3.5
Reduced cash flow requirements	3.5	2.8	3.2	3.1
Less demand on cash assets	4.5	2.8	2.8	3.0
Less financial risk	1.5	2.0	2.4	2.2

** Maximum score: 80, minimum score: 16*

As can be seen in Table 4.24, ranking between the D&IBs and BA&POLCs groups is relatively consistent and highly correlated. All reasons were ranked in the same order by the two groups. Similarly, lower acquired asset prices, reduced cash flow requirements and less financial risk, are placed by the PFIs group in the same order, as second, third and fifth, as by the other two groups. But less demand on cash asset and tax benefits to the lessors have a reverse ranking to the other two, which place them in fourth and first place, respectively.

4.12 FORM OF LEASING CONTRACTS

As can be seen in Table 4.25, approximately 32 % of the respondents in the survey were using a standard leasing contract for all kinds of leasing agreements. The remaining lessors (68 %) were also using a standard leasing contract, but more flexible to the individual customers who were allowed a few amendments. Standard leasing contracts were generally drafted to cover the general conditions to the lessors' contentment and the satisfaction of most lessees, therefore time-consuming negotiation of terms can be avoided.

Table 4.25

Form of leasing contracts

Forms	Lessor type			All lessors
	PFIs	D&IBs	BA&POLCs	
Standard format	50.0	40.0	22.2	31.3
Customise to individual contract	50.0	60.0	77.8	68.7
Total	100 %	100 %	100%	100%

4.13 INFLUENCE OF LESSORS ON LESSEES' DECISION TO CHOOSE EQUIPMENT SUPPLIER

The lessors were also asked whether they attempted to influence the lessees in their choice of equipment supplier during the leasing agreement process.

Only six respondents (37.5 %) stated that they did. Five of these lessors were in the BA&POLCs group and the other one was in the D&IBs group. None of the lessors in the PFIs group try to influence their customer in their decision to choose a supplier or dealer. Leasing companies which attempt to influence the lessees to choose a supplier, as can be seen in Table 4.26, did so under different possible conditions, such as before a lessee has decided on a supplier, or if the lessor has an agreement with a supplier on a specific asset. Whilst only one company, among the six lessors, tried to influence the lessees under only one condition, when the lessees were asked for advice, the other five lessors indicated that they tried to influence them under more than one condition, with the majority combination of when the lessors were asked for advice about the supplier.

Table 4.26

Influence on lessees to choose a supplier (%)

	Yes (%)	No (%)
Does lessor attempt to influence the lessee ?	37.5	62.5
(a) Before a lessee has decided on a supplier	50.0	
(b) When lessee asks for advice	66.7	
(c) When lessor has an agreement with a supplier	50.0	
(d) When lessor knows better offer is available elsewhere	50.0	

Notes: The total of a, b, c, d is more than 100 per cent because five lessors used more than one way. The combinations are: (b), (ac), (ad), (bc), (bd), (abcd).

A few lessors (18.8%) had agreements with the manufacturers or dealers that they will recommend to their clients that they contact a particular manufacturer or dealer.

4.14 SEASONALITY OF LEASING BUSINESS

Table 4.27 shows the position of the seasonality of leasing business for the years 1991 and 1992. The data in the table are based upon figures supplied by seven leasing companies for 1991, and by thirteen companies for the year 1992. The data cover 96.5 % and 89.7 % of the total sample leasing business, and 34.5 % and 46.4 % of the total leasing business contracted by all lessors in Turkey for the two years, respectively.

Table 4.27

Seasonality of leasing business

Quarter ending	1991				1992			
	PFIs	D&IBs	BA& POLCs	All lessors	PFIs	D&IBs	BA& POLCs	All lessors
31. 03	8.5	0	8.4	6.0	4.0	0	7.3	5.7
30. 06	11.0	50.0	20.7	27.7	19.0	4.0	17.4	15.6
30. 09	53.5	0	25.1	22.0	17.5	24.4	13.6	15.8
31. 12	27.0	50.0	45.8	44.3	59.5	71.6	61.7	62.9
Total	100 %	100%	100%	100%	100 %	100%	100%	100%

The quarterly distribution of leasing contracts varies from lessor to lessor. There is no consistent pattern between the three groups for 1991, with the exception of all sectors executing the least percentage of their leasing business in the first quarter. But compared to 1991, the figures for 1992 are relatively consistent. The lowest percentage of total leasing business was transacted in the first quarter by all three sectors. Similarly, the largest percentage was contracted in the last quarter by all groups. Business in the second and third quarters of the year was spread more or less evenly. The second and third largest percentage of business were placed in the 2nd and 3rd quarters. However, D&IBs have a reverse percentage of their total business to the other two sectors, which places them into the 3rd and 2nd quarters, respectively.

4.15 EFFECT OF VAT INCREASE IN 1989 ON LEASING INDUSTRY

The VAT rate on some item purchases destined for leasing was increased in 1989. For example, on trucks and commercial vehicles, and on cars, this rate was increased from 1 % to 5 % and 10 %, respectively.

Lessors were asked how these increases affected their leasing business volume in that year and later years, and were also asked to indicate how strongly the given factors were affected.

The majority of the respondents (79%) who were in the leasing business in 1989 stated that the increase in the rate of VAT on some items did not affect their business volume considerably. Only three respondents estimated that their leasing volume was about 10-20 % less than they expected in 1989.

The level of the effect of the increase in the rate of VAT on the given factors, as perceived by lessors, is summarised in Table 4.28.

Respondents were asked to mark the level of effect on given factors on a scale of 1 to 5 in which

- 1 indicated large decline
- 2 small decline
- 3 no major effect
- 4 small increase
- 5 large increase

The values of each factor for each respondent give an aggregate score for that factor. The maximum score for each factor is 80 with a maximum of 5, and the minimum score for each factor is 16 with a minimum of 1. The level of effect for each factor was then averaged and ranked for the three types of lessors, as shown in the Table 4.28.

It is seen that the effect of the VAT rate increase on the given factors in all three sectors is relatively consistent and correlated. With the exception of a reverse ranking to the other two groups in group D&IBs of cost of funding and competition in the leasing market, which places them in second and third place, respectively, all other factors are placed in the same order by all three sectors.

Table 4.28

Effect of increase in VAT rate on some factors

Factors	Lessor type			All lessors
	PFIs	D&IBs	BA&POLCs	
Cost of funding	4.5	3.3	3.3	3.5
Competition on leasing market	3.5	3.5	3.2	3.3
Risk on leasing activities	3.5	3.3	3.2	3.2
Margin of leasing	2.0	2.5	2.3	2.3

** Maximum average score: 5, minimum average score: 1*

According to all lessor groups, cost of funding, competition in the market, and risk in leasing activities were slightly increased. All lessors also agreed that margin on leasing business had a contraction.

Respondents were also asked what their estimated leasing volume would have been in the years 1990 to 1992 if there had been no VAT increase in 1989. 5,7 and 9 leasing companies replied for this question for 1990, 1991 and 1992, respectively. All lessors for these three years indicated that they were estimating an increase of their total leasing volume but this varied from company to company between 10 to 50%. The expected increase of leasing volume by the type of lessors is given in Table 4.29.

Table 4.29

Expected leasing volume if there had been no VAT increase in 1989

Year	Lessor type			All lessors
	PFIs	D&IBs	BA&POLCs	
1990	35.0	10	13.0	21.0
1991	35.0	27.0	15.0	26.0
1992	35.0	27.0	16.0	24.0

According to the table, it seems that PFIs was the most affected sector; in other words, increases of the VAT rate in 1989 caused the loss of one quarter of sector business in 1990, 1991 and 1992. BA&POLCs was the least affected group.

4.16 EVALUATION OF LEASE PROPOSALS

Table 4.30 gives the main lease investment evaluation techniques for lease proposals used by the lessors in the period 1987-1992.

It is of interest to note that, while the popularity of IRR and NPV was growing, the traditional payback period method is still one of the most widely used for evaluation of lease proposals by many lessors.

Table 4.30

Evaluation techniques used by lessors for lease proposals

Evaluation techniques	Lessor type			All lessors
	PFIs	D&IBs	BA&POLCs	
Internal Rate of Return	50.0	80.0	88.9	81.3
Payback method	50.0	80.0	44.4	56.3
Net Present Value	-	60.0	33.3	37.5
Other methods	50.0	-	11.1	12.5

As can be seen in Table 4.31, only approximately 31 % of lessors used a single evaluation method, and the other leasing companies in the sample (68.8 %) stated use of more than one evaluation technique, with internal rate of return and payback method being the most popular combination.

Table 4.31

Combination of evaluation techniques used by lessors

One method	Two methods	Three methods
(a) 18.8	(ab) 18.8	(abc) 18.8
(b) 12.5	(ac) 18.8	
	(ae) 6.2	
	(be) 6.2	
31.3 %	50.0 %	18.8 %

Note: (a): IRR, (b): Payback, (c): NPV, (d): Other methods

Two reasons may be given why lessors use more than one technique. First, it may indicate that a single technique was not sufficient for the decision makers to understand and assess the proposals. Second, compare the techniques and choose the best which reflects the lease proposals.

4.17 PERFORMANCE OF LESSORS

A question was asked on the criteria which lessors use to assess their companies' performance regarding their leasing activities. A sizeable proportion of respondents (75 %) indicated that they used more than one (two-three-four) criterion. As can be seen in Table 4.32, the majority use a combination of net profit after-tax and total value of assets of new contracts.

Table 4.32

Combination of criteria used to assess companies' performance

Number of criteria used by lessors (%)				
One	**Two**	**Three**	**Four**	**Five**
a 6.25	ab 12.5	abc 6.25	acdf 6.25	abcde 6.25
b 6.25	ad 6.25	abd 6.25	acef 6.25	
c 6.25	af 12.5		bcde 6.25	
e 6.25			bcdf 6.25	
25.0%	31.2%	12.5%	25.0%	6.3%

Note: (a): Net profit after-tax, (b): Total value of assets of new contracts, (c): Total receivable income during a financial year, (d): Total number of new contracts, (e): Net profit before-tax, (f): Others

The other criteria used were total receivable rental income during the year (43.8 %), total number of leased contracts (31.2 %), and net profit before-tax (25 %) (see Table 4.33). The fact is that in the combination a large percentage of the respondents appeared to use two criteria at the same time. One may conclude that lessors, first of all, select the most suitable criterion according to company's age, size and expected rate of growth, and secondly, another criterion (most possibly, net profit after-tax) which can measure the company's profitability compared to other lessors in the industry and/or prefixed target rate.

Table 4.33

Criteria for assessing companies' performance

Criterion	Lessor type			All lessors
	PFIs	D&IBs	BA&POLCs	
Net profit after-tax	50.0	60.0	77.8	68.8
Total value of assets of new contracts	100	40.0	44.4	50.0
Total receivable income during a financial year	-	60.0	44.4	43.8
Total number of new contracts	-	-	55.6	31.3
Net profit before-tax	-	20.0	33.3	25.0
Others	-	20.0	55.6	37.5

4.18 INVESTMENT INCENTIVES AND LEASING CONTRACTS

As discussed in Section 2.2.6.5, if an investment project which qualified for special incentives, according to geographical area, type of industry and total value of investment, is financed by leasing, every benefit of incentives transfer to the lessor from the investor. Investment incentives include corporate tax exemption, varying between 30 to 100 %, and customs duties exemptions.

Questions were put to the lessors to give the number of their lease contracts and their value, which qualified for investment incentives during the period 1987-1992, and the approximate percentage of tax-free leasing business of their total leasing transactions in the same period.

When the respondents were analysed by the number of lease contracts and by contracts volume of investment incentives, statistically significant results were observed between the respondent sectors. As can be seen in Table 4.34, whilst in terms of number, approximately 66 %, and in terms of value, 69 % of total investment incentives projects were financed by the D&IBs lessors, PFIs and BA&POLCs lessors were contracted, in terms of number of contracts, 4 % and 30 %, and in terms of value, 17 % and 14 %, respectively. In addition, another significant difference also appears between the lessor groups, when leasing contracts with investment incentives project are compared to total leasing contracts during the years of survey. Table 4.35 shows that about 60 % of the total D&IBs' leasing contracts volume were with incentives projects, while PFIs' were about 7 % and BA&POLCs' were only about 4 %.

Table 4.34

Leasing contracts with investment incentives projects (1987-1992)

	Lessor type			Total
	PFIs	D&IBs	BA&POLCs	
Number of contracts	3	57	26	86
Percentage	3.5%	66.3%	30.2%	100%
Value of contracts ($US 000)	15750	65140	13258	94148
Percentage	16.7%	69.2%	14.1%	100%

Table 4.35

Percentage of incentives to total leasing business (1987-1992)

	Lessor type			All lessors
	PFIs	D&IBs	BA&POLCs	
Number of contracts	0.14	39.3	0.73	1.46
Value of contracts	6.80	59.94	3.54	13.17

One can note that D&IBs were financing investment projects and equipment which were in specified geographical locations and/or specified economic sectors which have more risk than the other regions and sectors. This is because investment incentives mainly applied to less developed areas and more risky industries. In the event of lessee withdraw or failure on investment, the lessor must repay the total value of incentives received with interest. This obviously imposes an additional financial risk on lessors. On the other hand, because this investment type has many tax advantages, D&IBs may make more profit after-tax than the other groups of lessors. This may also bring competition advantages to this group and they may offer cheaper finance to the lessees than market price.

The responses to the question on approximate percentage of tax-free leasing in total leasing business during the period 1987-1992 are given in Table 4.36. The table indicates that approximately 56 % of respondents had 0-25% tax-free leasing business. Only about 12% of respondents stated that their tax-free business covers only 25-50% of their total leasing business, and about 31 % of respondents indicated 75-100%.

It should be noted that the question does not precisely identify 0%, therefore 56 % of the respondents who stated that they had 0-25% of tax-free leasing business may also be indicating 0 %, too.

Table 4.36

Percentage of tax-free to total leasing business (1987-1992)

Tax-free percentage	% of lessor by type			All lessors
	PFIs	D&IBs	BA&POLCs	
0-25	50.0	40.0	66.7	56.3
25-50	-	-	22.2	12.5
50-75	-	-	-	-
75-100	50.0	60.0	11.1	31.2

4.19 PROFIT ON TOTAL LEASING ACTIVITIES

One of the common measures of performance in the leasing industry is lease return which is defined as annual profit expressed as a percentage of the total leasing turnover. As can be seen in Table 4.37, for analysis of profitability for each year, a different number of lessors responded. All respondents, with one exception in the PFIs group, indicated that their profit to total leasing turnover was 1/4 or less. Only one lessor stated profit ratio to total turnover as 1/1.

Table 4.37

Percentage of profit to total leasing turnover

	Number of	Percentage of profit	
Year	companies	1/4	1/1
1987	1	100 %	
1988	1	100 %	
1989	2	50.0 %	50.0 %
1990	4	75.0 %	25.0 %
1991	8	87.5 %	12.5 %
1992	14	93.0 %	7.0 %

The measurement of performance of a lessor is a very complex matter, because of varying accounting practices for preparation of financial statements, different calculation of depreciation, and different cost of funding, which all affect performance as well as profit margin.

4.20 ACCOUNTING PRACTICES

As was discussed earlier, according to Turkish Financial Leasing Law 3226 the lessors capitalise leased assets and this shows on their balance sheet. The leased assets are depreciated over their useful economic life either on a straight-line or accelerated basis. The rental received by the lessors is recognised as income and is subject to corporate tax.

From this, questions arise as to what an asset's economic life is, who can decide on the life period and how, and which depreciation method is used for leased assets by the lessors.

Questions were asked of the lessor in order to clarify these grey areas. A question was also asked to confirm whether lessors apply the legal requirements for recording leased assets on companies' balance sheets as a fixed asset or not. All (100%) respondents stated that they did record leased assets on their balance sheet as a fixed asset.

As can be seen in Tables 4.38 and 4.39, 15 respondents in the sample indicated that the expected economic life of a leased asset was decided by different authorities. Whilst approximately 67 % of respondents gave only a single authority, about 33 % stated that one and/or another could decide. The majority of respondents (66.7%) agreed that legislation is the authority, but three lessors out of ten combined legislation with another.

Table 4.38

Decision on economic life of leased assets

Decision authority	Lessor type			All lessors
	PFIs	D&IBs	BA&POLCs	
Legislation	100	40.0	66.6	66.7
Lessor	50.0	40.0	22.2	33.4
Lessee	-	20.0	11.1	13.3
Supplier company	-	20.0	11.1	13.3
Others	50.0	-	-	6.7

Note: Total of each group is more than 100% because some lessors gave more than one authority.

Table 4.39

Combination of authorities for decision on economic life of leased assets

Number of decision authorities given by lessors (%)	
One authority	Two authorities
a 33.3%	ab 6.7%
b 13.3%	ad 13.3%
c 13.3%	ae 6.7%
d 0 %	bd 6.7%
e 6.7%	

Note: (a): Legislation, (b): lessors, (c): lessees, (d): supplier companies, (e): others.

Tables 4.38 and 4.39 indicate that lessors had no certain idea of the authority responsible to decide on an asset's economic life period. Generally, the lessor first applied to legislation if they could not find any clear clause for the specific asset which they were looking for, then elsewhere, mainly to the leasing companies themselves. The lessees and supplier companies were also considered as an authority.

After an asset's economic life period has been decided, the asset is depreciated over its useful economic life. Table 4.40 shows that about 62% of lessors in the sample survey indicated that they used the straight-line depreciation method. Only about 13% of the respondents stated that they were using the accelerated method. The rest, 25%, preferred either the straight-line or accelerated method according to the type, period of economic life of assets, and general economic situation of the country. It is of interest to note that in an average of 60-70 % inflation rate environment, the respondents were not using the accelerated depreciation method which provides faster recovery of cost and earlier tax advantages, but the traditional straight-line method.

Table 4.40

Depreciation method used by lessors

Depreciation method	Lessor type			All lessors
	PFIs	D&IBs	BA&POLCs	
(a) Straight-line	50.0	80.0	55.6	62.5
(b) Accelerated	50.0	20.0	-	12.5
Both (a) and (b)	-	-	44.4	25.0
Total	100%	100%	100%	100%

4.21 FORECAST FOR LEASING INDUSTRY

Evidence from the survey of lessors suggests that there will be a market increase in the demand for leasing business. Approximately 88 % of the lessors in the sample predicted the general future of the leasing industry will be either good or very good. Only two respondents believed that the leasing market, in general, will be uncertain. Two reasons were given for uncertainty:

- Unstable economic trends, such as unpredictable inflation rate and unexpected sharp decline in the value of the Turkish Lira which cause high costs for funding leasing activities and unreliable financial market.

- High competition in the market with new lessors persuades the lessors to enter more risky agreements in order to find a secure niche or increase their share in the market.

As can be seen in Table 4.41, the majority of lessors had confidence that the future of the leasing industry in Turkey will be bright. The main reasons given for optimism are:

- There is no medium and long-term source of finance other than leasing.
- The leasing industry in Turkey is still very young, companies are unaware of the advantages of leasing. Through awareness of leasing advantages companies will prefer leasing to other sources of financing.
- Tax advantages and conserving working capital make leasing preferable.
- Leasing has a big potential market.
- With a few amendments of Turkish Financial Leasing Law companies will be encouraged to lease.

Table 4.41

Future of leasing industry in general

Criterion	Lessor type PFIs	D&IBs	BA&POLCs	All lessors
Very good	-	20.0	22.2	18.8
Good	50.0	80.0	66.7	68.7
Unchanged	-	-	-	-
Very uncertain	50.0	-	11.1	12.5
Bad	-	-	-	-
Very bad	-	-	-	-
Total	100 %	100 %	100 %	100 %

The vast majority of respondents also predicted the future of their own particular sector will also be very bright. Respondents appeared to have slightly more confidence in their own particular sector than in the general leasing sector. Only one respondent, who maintained that the future of leasing industry in general will be uncertain, predicted that his own particular sector will be also uncertain.

As can be seen in Table 4.42, respondents' perceptions of both the general and their particular sectors were very closely linked. All respondents who saw the future of general leasing as good also perceived their specific market in the same way.

Table 4.42

Future of leasing industry by particular sectors of lessors

Criterion	Lessor type			All lessors
	PFIs	D&IBs	BA&POLCs	
Very good	-	-	22.2	12.5
Good	100	100	66.7	81.2
Unchanged	-	-	-	-
Very uncertain	-	-	11.1	6.3
Bad	-	-	-	-
Very bad	-	-	-	-
Total	100 %	100 %	100 %	100 %

Table 4.43 also reflects that the future of the leasing business is very bright. Thirteen out of sixteen respondents expected their future leasing turnover to be increased related to the previous year. All respondents forecast from 30% to 600 % increase in their business volume for the next three years.

Table 4 43

Anticipated future leasing volume (increase %)

Year	Lessor type			All lessors
	PFIs	D&IBs	BA&POLCs	
1993	80.0	130.0	240.0	160.0
1994	80.0	135.0	110.0	110.0
1995	80.0	95.0	100.0	95.0

If the respondents forecast their leasing volume precisely, considering the Turkish Lira daily valuation against foreign currency, one can forecast the total leasing volume for the years 1993, 1994 and 1995 as $US million 940, 1456 and 2112, respectively.

Regarding plans for future leasing business, only one respondent (6.3%) in the D&IBs group plans to stay on the same course. The remaining vast majority (92.7%) were looking to extend their leasing business transactions. Plans for the future were generally based on their leasing business activities where business had extraordinary growth rates of about 140 % in 1992 relative to 1991 volume. Lessors' plan are summarised in Table 4.44.

Table 4.44

Lessors' plans for future leasing

Plans	Lessor type			All lessors
	PFIs	D&IBs	BA&POLCs	
Expansion	100	80.0	100	93.7
Contraction	-	-	-	-
No change	-	20.0	-	6.3
Cessation	-	-	-	-
Total	100 %	100 %	100 %	100 %

Table 4.45 also indicates that the sample companies are quite optimistic that leasing business will grow and many new lessees will prefer to finance their investment project with leasing. As can be seen in the table, 25 % of the sample lessors increased their leasing branches from 9 to 26 in total (from 5,1,3, and 1 to 13,3,7 and 2, respectively). 50 % of the respondents also increased their staff, in total, from 224 to 788. Again, about 63 % of respondents increased their capital approximately 540 % after they commenced their leasing business, from TL 137.5 billion to TL 876 billion.

Table 4.45

Growth of the lessors

	In total		**Increase**	**Number of lessors**
	From	**To**	**(%)**	**(%)**
Branches	9	26	190	25.0
Staffs	224	788	252	50.0
Capital (TL billion)	137.5	876	537	63.0

4.22 GENERAL VIEW FOR LEASING INDUSTRY

Two open-ended questions were also asked of the respondent. The first was concerning any action that the Turkish Government should take in order to improve leasing activities. All respondents gave their own ideas which can mainly be summarised as follows:

- Lift the double taxation on real asset leasing. All rental receivable, including principal and interest, although the principal is not real income, is subject to corporation tax. At the end of the lease term, if the purchase option is exercised by the lessee, the ownership of an asset transfers to the lessee at a nominal price, which is also subject to corporation tax. In the case of any asset leased, with the exception of real assets, the principal cost is compensated by the depreciation tax shield, and because of the high depreciation rate, by the end of the lease contract the value (nominal) of the asset is so small that tax on the nominal value is also small. In the case of real estate, because of only 2% depreciation rate, neither the principal can be compensated nor, when the lessee exercises the purchase option at the end of the lease period (minimum four years), the purchase price will be nominal but market price. Therefore, either this or that way the lessor's rental receivable and/or sale price, which is not real income, will be taxed. Two solutions were proposed:

  1. Either increase the depreciation rate, or
  2. only interest rate incomes should be subject to the corporation tax.

- As discussed earlier, in the case of an incentives project financed by leasing, all benefits transfer to the lessor, but in the event of failure by a lessee all benefits which the lessor held must be returned with legal interest. This unfair situation must be lifted.

- Help to find long and medium-term credit in order to finance leasing activities.

- For any type of asset the leasing period should be reduced from four years to less, not only for computers and cars.

- For the sake of perfect competition, leasing assets should be recorded not as fixed assets, but as loan. Therefore, assets should be recorded on lessees' balance sheet as fixed assets.

- Sub-lease should be permitted.

- The leasing market should be prepared for operational leasing transactions.

The second open-ended question was asked regarding any specific factors which can affect future leasing demand. This was also replied to by all respondents in the sample. The main ideas expressed are summarised as follows:

- Increase real estate depreciation rate from 2 % to between 10-25 %.

- Permission to sub-lease and operational lease.

- Make the advantages of leasing known to investors and public.

- More co-operation between the authority and lessors.

- More flexible lease period.

- All leasing companies which are in the leasing business in Turkey should be united without any discrimination into a single association and avoid harmful competition.

- Ownership transfer tax on real estate (4% for each, seller and buyer) should be lifted.

- The VAT advantages of leasing should continue.

CHAPTER FIVE

Results and analysis of lessees' questionnaire

CHAPTER FIVE

RESULTS AND ANALYSIS OF LESSEES' QUESTIONNAIRE

5.1 INTRODUCTION

This chapter contains the presentation and analysis of the data provided by the lessees' survey questionnaire (see Appendix B). The broad aim of the lessees' survey was to investigate the behaviour of firms with respect to leasing and obtain a general overview of leasing practice.

The analysis of the lessees' questionnaire gave replies on the following:

- Companies' policies towards leasing,
- how a firm chooses the lessor,
- type of asset leased,
- factors taken into account when deciding to lease or not to lease,
- accounting practices on leased assets,
- effect of tax change on the lease decision.

The analysis of data also shows how lessees assess lease proposals to determine whether leasing is economic, compared with other available alternatives.

5.2 RESPONSE RATE

The total responses for the survey carried out for lessees and potential lessees in Turkey for the period of six years between 1987 and 1992 (the same period of study as for lessors) are summarised in Table 5.1 and Figure 5.1.

Table 5.1

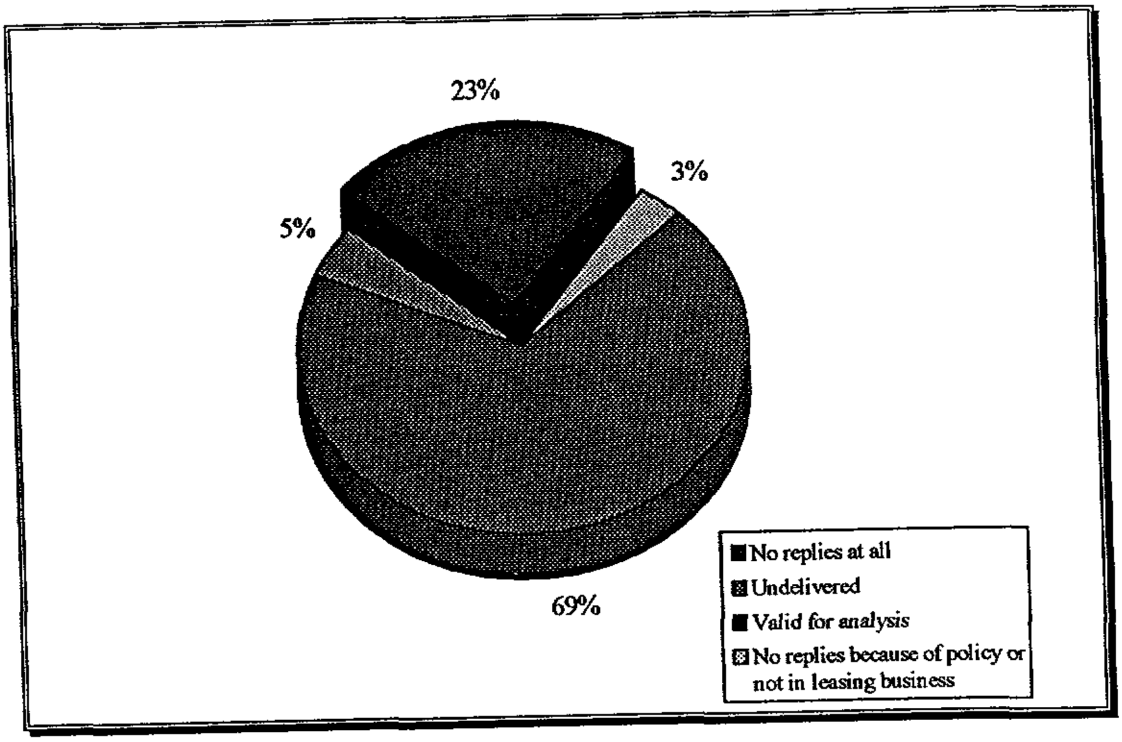
Response rate of lessees' postal questionnaire

Total sample size	**250**
Number of questionnaires returned undelivered	**12**
Number of questionnaires returned not completed because of company policy or not being in leasing business	**8**
Total number of questionnaires suitable for analysis	**57**
Response rate of valid replies	**23.0 %**

For the survey a separate questionnaire was sent to 250 lessees and potential lessees in Turkey. Within the time allowed, replies were received from 65 companies, representing a response rate of 26 %.

Figure 5.1

Response rate of lessees' postal questionnaire



Location of companies

Table 5.2 indicates the location of all companies surveyed and of the 57 companies responding to the questionnaire. As can be seen in the table, the majority of respondents' (64.9 %) companies were located in Marmara, which includes İstanbul, the most developed region in Turkey, and where over 80% of the lessors' head offices are located. None of the companies of the valid 57 respondents were located in either East or South-east Anatolia. Central Anatolia was placed second with twelve companies, and Mediterranean and Aegean shared the same place with three companies each, the Black Sea region was represented by two companies.

Table 5.2

Regional allocation of companies surveyed

Regions	Companies surveyed		Companies responded	
	Number	Percentage	Number	Percentage
Marmara	115	46.0	37	64.9
Aegean	30	12.0	3	5.3
Central Anatolia	54	21.6	12	21.1
Mediterranean	22	8.8	3	5.3
Black Sea	13	5.2	2	3.5
East Anatolia	9	3.6	0	0.0
South-east Anatolia	7	2.8	0	0.0
Total	250	100%	57	100%

5.3 THE SAMPLE

Size of companies by employees

For the purpose of analysis, as is shown in Table 5.3, the 57 responding companies in the sample were classified by employee size. They were categorised into one of the three classes:

- Small → up to 99 employees
- Medium → from 100 to 999 employees
- Large → 1000 and over employees.

As can be seen in the table, the composition of respondents was biased towards large firms: 14 % of responding companies were in the 1-99 employee size, 35 %, were in the 100-999, and 51% were in the more than 1000 employee size, showing that the sample contains a sufficient number of companies to allow comparison to be made between all sizes of companies.

Through the six years 1987-1992, about 30 % of respondent companies (lessees) were involved in leasing activities, while 70 % of companies (not lessees) had not negotiated any lease contracts at all. Therefore, the common method of acquisition of assets was still outright purchase. As can be seen in Table 5.3, although there is nearly the same tendency to use leasing in all three sizes of companies, large firms tend to make more use of leasing than other groups. Within each group (small, medium, large) there were 25 %, 20 % and 38% of respondents who were lessees.

Table 5.3

Distribution of respondents and lessees by company size

Size of firms	Respondent companies		Lessees		Lessees/respondent companies
	Number	%	Number	%	%
Small	8	14.0	2	11.8	25.0
Medium	20	35.1	4	23.5	20.0
Large	29	50.9	11	64.7	37.9
Total	57	100%	17	100%	29.8

Sector type

Table 5.4 indicates that in the distribution of respondents by companies' sector, the majority of questionnaires were completed by private companies (81%). Only 14 % of replies came from public companies and about 5 % were returned by mixed (private and public partnership) companies. These figures compare with the following make-up of the sample of companies surveyed.

Table 5.4

Distribution of companies by sector

Sector type	Respondent companies		Lessees		Companies in sample	
	No	%	No	%	No	%
Public companies	8	14.0	-	-	49	19.6
Private companies	46	80.7	17	100	190	76.0
Mixed companies	3	5.3	-	-	11	4.4
Total	57	100%	17	100%	250	100%

Table 5.4 also shows that all 17 companies involved in leasing activities were within the private sector. None of the public or mixed companies in the sample negotiated a single leasing agreement during the period 1987-1992.

Position of respondents in the company

Table 5.5 indicates that over half of the 57 questionnaires were completed by respondents who were accounting and finance directors of their leasing companies, 11 were managing directors, 6 were deputy managing directors and four were credit and marketing directors. From the lessees' point of view, over 50 % of the respondents were also accounting and finance directors, and about 24 % were managing directors of their companies.

Table 5.5

Classification of respondents according to position in company

Positions	Respondent companies		Lessees	
	Number	%	Number	%
Managing director	11	19.3	4	23.5
Deputy managing director	6	10.5	1	5.9
Accounting & finance director	29	50.9	9	52.9
Credit & marketing director	2	3.5	-	-
Project & planning director	1	1.8	1	5.9
Others	4	7.0	2	11.8
No answer	4	7.0	-	-
Total	57	100%	17	100%

Type of industry

80 % of the sample companies responding classified themselves as a manufacturing company, and the second highest, about 16 %, classified themselves as distribution and service. On the basis of this sample it is likely that a useful analysis would be made by comparing manufacturing and distribution and service companies' leasing attitudes and practices. Table 5.6 shows the distribution of the sample companies by industry. Again, the sample contains a sufficient number of companies of each type to allow comparison. The data in the table indicate that the highest percentage (17.5 %) of the companies surveyed were in the iron, steel and metal manufacturing industry, the next highest industries were textile and petroleum, gas and electricity (14.0% and 12.3%, respectively).

As can be seen in the table, with the exception of textile and food and drink, all types of industry negotiated lease contracts in the years 1987-1992. The chemical and allied industry ranked the highest with 5 (29.4 %) companies. The remaining industries were represented by one or two companies during the same period of study.

Table 5.6

Distribution of companies by industry

Type of industry	Respondent companies		Lessees	
	Number	%	Number	%
Petroleum, electricity and gas	7	12.3	1	5.9
Paper, packing and printing	3	5.3	2	11.8
Iron, steel and other metal industry	10	17.5	2	11.8
Glass, ceramics and cement	3	5.3	2	11.8
Textile	8	14.0	-	-
Automotive and its auxiliaries	6	10.5	2	11.8
Food and drink	4	7.0	-	-
Chemical and allied industry	6	10.5	5	29.4
Trade and marketing	4	7.0	1	5.9
Others	6	10.5	2	11.8
Total	57	100.0	17	100%

Tax position

The vast majority of companies in the sample were tax-paying firms during the period of study, 1987 to 1992. The question referred to whether the companies were paying corporation tax or not. If a company is subject to corporation tax, this becomes a key factor in whether or not it is cheaper to lease. As can be seen in Table 5.7, approximately 95% of respondents and all lessees in the sample paid corporation tax for all six years of the period of study.

Table 5.7

Tax-paying position of the companies for 1987-1992

Years	Respondent companies		Lessees	
	Number	%	Number	%
1987	54	94.7	17	100
1988	55	96.5	17	100
1989	55	96.5	17	100
1990	53	93.0	17	100
1991	54	94.7	17	100
1992	55	96.5	17	100

5.4 ATTITUDES TO LEASING

Leasing decision

As discussed earlier in Chapter 2, the published literature to date indicates that there is disagreement among academics as to whether the decision to lease is an investment decision or a financial decision.

In practice, managers may face a different situation. Therefore lessees and potential lessees in the sample were also asked how management regard the leasing decision. As can be seen in Table 5.8, approximately half of the respondents considered that a leasing decision is a financial decision, therefore an acquisition decision was considered separately from a financing decision. On the other hand, about 40 % of respondents considered that a lease decision is a combination of both investment and financial decisions, thus those companies consider both decisions simultaneously. Only 7 % of the respondents saw it as purely an investment decision.

It is of interest to note that none of the lessee companies (17) in the sample regarded a lease decision as an investment decision. Just as Beechy (1969), Ofer (1976), McConnell and Schallheim (1983), Bower (1973), Clark (1978) and Nunnally et al. (1991), agree that the decision is a combining of investment and financing decisions, about 65% of lessees also considered it as a combination of both decisions. The remaining (35%) lessees in the sample considered, like Sykes (1976), Hubbard (1980), Van Horne (1983), and Pike and Dobbins (1986), that there are two separate decisions, and leasing is a financial decision to be made subsequent to the investment decision.

Table 5.8

Consideration of leasing decision

Decision	Lessees		All respondent companies	
	Number	%	Number	%
A-Investment	-	-	4	7.0
B-Financial	6	35.3	28	49.1
Both (A and B)	11	64.7	23	40.4
No answer	-	-	2	3.5
Total	17	100%	57	100 %

<u>Management attitudes</u>

With regard to management attitudes, as can be seen in Table 5.9, over half of the respondents (52.6%) were neither for or against leasing; they held no opinion at all. Of the rest, the majority were in favour of leasing (36.8%). Only 3.5% of respondents were against leasing. Within the 'against leasing' group, 50 % (1/2), and within the neutral group, 16.7 % (5/30) did in fact lease. As is shown in the table, 42.9 % (9/21) respondent companies in the 'favour of leasing' group had at least one lease in the period 1987-1992.

Table 5.9

Management attitudes to leasing

Management attitudes	Lessees		All respondent companies	
	Number	%	Number	%
Favour leasing	9	52.4	21	36.8
Oppose leasing	1	5.9	2	3.5
Neutral	5	29.4	30	52.6
Other	1	5.9	2	3.5
No answer	1	5.9	2	3.5

From the point of view of firm size and management attitudes to leasing, as can be seen in Table 5.10, the majority of all three sizes of companies' management did not show a predominant bias towards either leasing or not leasing. They showed about the same proportion in favour of leasing. Approximately 32% of large firms which were 'in favour' or had 'no general opinion' about leasing, were lessees. Small and medium firms also showed about the same proportion of lessees 'in favour of leasing' and 'no general opinion', 25 % and 22%, respectively. It is of interest to note that, although one company in the large company group was opposed to leasing, it had contracted a lease agreement.

Table 5.10

Management attitudes to leasing by firms' size

Management attitudes	Company size					
	Small		Medium		Large	
	Total	Less-ees	Total	Less-ees	Total	Less-ees
Favour leasing	3	1	7	2	11	6
Oppose leasing	-	-	1	-	1	1
Neutral	5	1	11	2	14	2
Other	-	-	1	-	1	1
No answer	-	-	-	-	2	1
Total	8	2	20	4	29	11

<u>Awareness of leasing</u>

The most influential factors in creating awareness of leasing are summarised in Table 5.11. 'The lessors' themselves appeared to be the most influential factor (40.4%) in creating the awareness of leasing. This was done by direct mailing from lessors and through the leasing companies' marketing staff efforts. The second most common factor which induced lessees to be aware of leasing is advertising in the financial and trade press (36.8%). Approximately 23 % of respondents said that conferences and seminars were the reasons for their knowing about leasing.

Table 5.11

Companies' awareness of leasing

Made aware of leasing by	Respondent companies		Lessees	
	Number	%	Number	%
Lessors	23	40.4	5	29.4
Financial and trade press	21	36.8	6	35.3
Financial institutions	18	31.6	9	52.9
Conferences and seminars	13	22.8	6	35.3
Lessees	3	5.3	1	5.9
Others	11	19.3	5	29.4

'Lessees' seem to have only a very small impact on the awareness of all respondents. From the sample lessees' point of view, in contrast, financial institutions were ranked as first for creating awareness by about 53% of all lessees. The roles of advertisement in the financial and trade press (35.3%), conferences and seminars (35.3%), and lessors (29.4%) were also conspicuous.

Choosing a lessor

As can be seen in Table 5.12, the most common method used by the sample companies in general (86.0 %), and actual lessees (88.2 %), who had signed leases between the years 1987 and 1992, was to choose a suitable lessor from several different detailed lease proposals from different lessors.

Table 5.12

Choosing a lessor

Selection method	Respondent companies		Lessees	
	Number	%	Number	%
Assessment of proposals from different lessors	49	86.0	15	88.2
Recommendation from equipment supplier	2	3.5	-	-
Use an existing lessor	1	1.8	1	5.9
Other	5	8.8	1	5.9

Approaching several lessors for quotes and then choosing the best alternative is dependent on various issues such as type of asset, payment schedule, and period of lease. The initial choice of lessor for a lessee is very important because of its influence on future possible choices. However, the majority of lessees in the sample preferred to choose one from among several; one lessee indicated that he had only one lessor who financed all the types of equipment he needed.

5.5 LEASING ACTIVITIES

5.5.1 Acquisition of assets

As can be seen in Table 5.13, an average of 50 % of the respondent companies, throughout the six years 1987-1992, acquired new assets which had a total value of about $US 1,454 million. The approximate proportion of new assets acquired by the respondent companies for the years 1987 to 1992 were 13.4%, 8.3%, 9.8%, 18.3%, 19.5% and 30.8%, respectively. During the same period, the total value of the leases contracted by the 17 lessees in the sample was around $US 15.8 million. This was only 1.1% of the total assets acquired by the 57 sample companies.

Table 5.13

Assets acquired in 1987-1992

Year	Acquired assets value ($US mil.)	Number of companies acquired assets	Value of leases ($US mil.)	Number of lessees
1987	194.2	20 (35.1 %)	-	1 (1.8 %)
1988	120.9	22 (38.6 %)	0.561	2 (3.5 %)
1989	142.1	25 (43.9 %)	0.470	2 (3.5 %)
1990	266.2	33 (57.9 %)	1.065	5 (8.8 %)
1991	283.3	34 (59.6 %)	11.018	10 (17.5 %)
1992	447.1	39 (68.4 %)	2.662	14 (24.6%)
Total	1453.6		15.776	

From the above table, it is evident that, for the majority of companies, outright purchase was the most common method of acquisition of assets, while the tendency towards leasing finance was generally less than 1%.

On the other hand, Table 5.13 indicates that the tendency to lease is increasing. Whilst only a single company (1.8 %) in the sample contracted a lease agreement in 1987, and two companies (3.5%) in 1988 and 1989, this increased to 10 (17.5%) and 14 (24.6%) companies in 1991 and 1992, respectively.

In terms of size of companies, about 65 % of both medium and large, and 88% of small-sized firms, acquired assets by both purchase and lease in the period 1987-1992. The approximate value of the assets by size of firms is summarised in Table 5.14(a).

As the table shows, 14.5 % of the assets were owned by the small companies. The proportion of medium and large companies was 30.6% and 54.9%, respectively.

Table 5.14(a)

Value of assets by type of companies both purchase and lease

$US Million	Type of companies						Total	
	Small		Medium		Large			
	No	%	No	%	No	%	No	%
Up to 100	14	8.1	5	2.9	11	6.3	30	17.3
100-1000	10	5.8	26	15.3	14	8.1	50	28.9
1000-5000	1	0.6	19	11.0	32	18.5	52	30.1
Over 5000	-	-	3	1.7	38	22.0	41	23.7
Total	25	14.5	53	30.6	95	54.9	173	100

No: Number which acquired assets in 1987-1992

It is of interest to note that the percentage of assets acquired by company size-group and composition of lease group are highly correlated. As is shown in Table 5.3, 14 % of the sample companies fall into the small group, 35% and 51% are in the medium and large groups, respectively. One may conclude that almost all firms in all three size-groups owned the same proportion of assets during the six years. Also, the large proportion (46.7%) of small-value assets (group A) acquired by small-sized firms, more than half (52.0%) of medium-value assets (group B) by medium-sized firms, and the vast majority (92.7%) of large-value assets (group D) owned by large-sized firms (see Table 14(b)).

Table 5.14(b)

Number of assets acquired by sample companies by years

(57 companies)

Year	Type of companies												Total			
	Small				Medium				Large							
	A	B	C	D	A	B	C	D	A	B	C	D	A	B	C	D
1987	1	1	-	-	1	2	3	-	1	2	4	5	3	5	7	5
1988	1	-	1	-	-	2	3	1	2	2	6	4	3	4	10	5
1989	1	3	-	-	-	4	2	-	2	2	5	6	3	9	7	6
1990	1	4	-	-	-	7	3	-	2	2	4	10	3	13	7	10
1991	4	1	-	-	2	5	4	1	2	2	7	6	8	8	11	7
1992	6	1	-	-	2	6	4	1	2	4	6	7	10	11	10	8
Total	14	10	1	-	5	26	19	3	11	14	32	38	30	50	52	41

Note: A: Up to $US 100 million, B: $US 100-1000 million, C: $US 1000-5000 million, D: Over $US 5000 million.

5.5.2 Assets leased

5.5.2.1 Size of leases

As shown in Table 5.3, during the survey period of the six years 1987-1992, about 30 % of respondent companies were involved in leasing activity. 17 of the respondent companies (lessees) signed a total of 77 lease agreements. 71.4% of the leases had a total value of about $US 15.8 million (two lessees did not give the total value of their 22 leases), with an average value of around $US 287,000.

The majority of lessees (60 %) limited their involvement in leasing to not more than 8% of new asset acquisition. On the other hand, two lessees had all new assets (100 %) leased, and one lessee 88 % of their new assets, during the survey period. Leases reported in this study were either mainly small or medium-sized leases. As can be seen in Table 5.15, about 29% (16) of individual leasing contracts were valued between $US 26,000 and $US 50,000, 33% (18) valued between $US 50,000 and $US 100,000, and 24% (13) contracts valued between $US 100,00d and $US 200,000. Each of the remaining 8 contracts were valued over $US 200,000. The majority of companies' individual leasing contracts were under $US 200,000; a total of about 15% of the respondents were therefore dealing with over $US 200,000 of leasing.

Table 5.15

Size of leases

Lease value ($US)	Number of contracts		Value of contracts ($US 000)	
	Number	Percentage	Value	Percentage
26,000-50,000	16	29.1	613	3.9
50,000-100,000	18	32.7	1231	7.8
100,000-200,000	13	23.6	1877	11.9
Over 200,000	8	14.6	12055	76.4
Total	55	100%	15776	100%

As can be seen in Table 5.15(a), for the six years, the total value of leased assets was only 1.1% of the total value of assets acquired by the sample companies. The corresponding percentage for lessees, taken as a group by themselves, was about 6.0%. In other words, only 6.0% of the total assets, valued at about $US 262.2 million, acquired by lessees during the six years 1987-1992, were financed by leasing. It should be noted that total lessees' owned, both leased and purchased, asset value to total asset value of the entire sample of companies was about 18.0%.

Table 5.15(a)

Size of leases (1987-1992)

	Year						Total
	1987	1988	1989	1990	1991	1992	
Number of leases	2	5	4	23	22	21	77
Leases no values given	2	3	2	6	5	4	22
Value of leases ($US 000)	-	561	470	1065	11018	2662	15776
Average lease value($US 000)	-	281	235	63	648	157	287
% of total assets value	-	0.46	0.33	0.40	3.89	0.60	1.09
% of lessees' assets value	-	6.5	1.5	1.5	18.6	3.1	6.0

In year 1987 no values for any leases were received. It should be noted that average lease values and other similar figures shown in Table 5.15 are accordingly derived from partial information only.

Although the value of leases in this study were mainly of small and medium-size, they were mainly negotiated by large-sized firms. As can be seen in Table 5.16, large firms tend to make more use of leasing than small companies. In terms of number, as well as value, the majority of leasing contracts were executed by large firms, with 75.3 %, and about 90 %, respectively, for number and value. Total lease value for the small and medium-group firms covers just over 10% of total leasing. This may reflect managerial sophistication and awareness of alternative methods of financing asset acquisition in large companies.

The responses also reflect that large companies are very attractive to lessors. Furthermore, these large companies may be able to employ highly qualified and experienced finance personnel who are aware of leasing and confident to finance their projects with new sources rather than traditional ones.

Table 5.16

Distribution of leases by size of company

	Number of contracts		Value of contracts ($USm)	
Company type	**Number**	**%**	**Value**	**%**
Small	4	5.2	0.469	3.0
Medium	15	19.5	1.161	7.3
Large	58	75.3	14.146	89.7
Total	77	100 %	15.776	100 %

Figures given in Table 5.16 must again be treated with caution as the values for 22 (all in large group) of the total 77 leases reported were not given and the figures in Table 5.16 were based mainly on the remaining 55 replies.

5.5.2.2 Regional distribution

The distribution of location of the lessees and lease contracts is shown in Table 5.17. This indicates that approximately 83 % of the lessees were located in the Marmara region, and in terms of number, they executed about 94%, and in terms of value, about 82% of lease contracts. Two reasons may be given why companies located in the Marmara region use leasing to finance their business activities more than the other regions. First, the majority of leasing companies' headquarters are located in the same region, therefore whenever a company needs to finance its project with leasing, it may be easier to reach the lessor than in another region. Furthermore, many leasing companies have no branches other than in Marmara (mainly in Istanbul). Therefore, it may be difficult for companies which are located in other regions to reach and compare leasing finance with its alternatives, and they also may not be aware of leasing, because of lack of information. Second, as the most developed area, Marmara is more attractive to the investors as well as to the employees. Thus, every year more projects are being invested in this region than in others, and highly qualified and experienced finance personnel who are aware of leasing can be employed.

Table 5.17

Distribution of lease contracts by region (1987-1992)

Region	Number of leases (value of leases %)						Number of lessees
	1987	1988	1989	1990	1991	1992	
Marmara	2 100%	5 100%	4 100%	23 100%	20 38.9%	18 99.2%	14 82.3%
Mediterranean	-	-	-	-	1 0.5%	2 0.6%	1 5.9%
Central Anatolia	-	-	-	-	1 60.6%	1 0.2%	2 11.8%
Total	2 100%	5 100%	4 100%	23 100%	22 100%	21 100%	17 100%

The table also indicates that companies which were located in regions other than Marmara had no lease contracts in the first four years of the period of study, but in terms of number, for the years 1991 and 1992, they contracted about 10% and 14% of all leases in the sample, which covers about 18% of total value of leases. It is evident that the tendency to lease, for companies located in other regions, also increases with awareness of leasing.

5.5.2.3 Type of equipment leased

Companies were asked to identify types of assets they leased and their value. As can be seen in Table 5.18, the survey indicated that only four main types of equipment were leased by companies. Vehicles ranked first with 10 (59%) lessees, manufacturing plant and machinery, and computer and office equipment shared the second place, each with 8 (47%) lessees. Whilst 7 (41%) lessees leased only one type of equipment, mainly manufacturing plant and machinery, the remaining 8 (47%) and 2 (12%) lessees leased two and three types of equipment, respectively.

It is interesting to note that in terms of number of contracts, while vehicles ranked first with about 47% (36), in terms of value, manufacturing plant and machinery ranked first, comprising more than three-quarters the total value of all leases, but second in number of contracts (22). Vehicle leasing started to drop from 16 to 9 and 4 in number of contracts, from $US 987,000 to $US 842,000 and $US 155,000, in value of contracts, from 1990 to 1991 and 1992, respectively. This was caused by the increase in VAT rate on commercial vehicles and cars in 1989 and 1991.

Table 5.18

Types of equipment leased

Equipment	Lessees	Number of Contracts	Value of contracts
Manufacturing plant & machinery	47.1 %	28.6 %	75.2 %
Computer & office equipment	47.1 %	20.8 %	2.1 %
Vehicles	58.8 %	46.8 %	19.1 %
Heavy vehicles & construction equipment	17.6 %	3.9 %	3.6 %
Total		100 %	100 %

Companies were also asked whether they leased or were going to lease any type of equipment in 1993. Six types of equipment were given for either actual leases or proposed leases by 13 (22.8%) of the respondent companies. Table 5.19 shows that computers and office equipment (30.4%), and manufacturing plant and machinery (30.4%) were either being leased or proposed for lease by more than 50% of the lessees.

13/57 (22.8%) companies, 3 of which had not leased any equipment at all before, cited a total of 23 lease contracts, either already executed (12) or proposed (11), in 1993.

Five (two manufacturing plant and machinery , two computer and office equipment , and one medical equipment) of the total 23 lease contracts, were proposed by three new lessees, two of which are located in Central Anatolia, and one in the Marmara region.

1993 leasing contracts indicate that manufacturing plant and machinery, and computer and office equipment are becoming increasingly popular in the leasing market. This result is also confirmed by UTFT statistics, which indicate that both types of equipment are recently showing the most growing percentage in the leasing market.

Table 5.19

Leasing contracts in 1993

Equipment	Currently leased		Proposed to lease	
	Number	%	Number	%
Manufacturing plant & machinery	2	16.7%	5	45.5%
Computer & office equipment	2	16.7%	5	45.5%
Vehicles	3	25.0%	-	-
Heavy vehicles & construction equipment	3	25.0%	-	-
Medical equipment	1	8.3%	1	9.1%
Textile machinery	1	8.3%	-	-
Total	12	100 %	11	100%

5.5.2.4 Type of industry

The analysis of leasing by type of industry for 1987-1992 is shown in Table 5.20, which indicates the relatively greater importance of leasing, among the seven industries, in the chemical, and glass, ceramics and cement industry. The analysis also reveals that the automotive and its auxiliary industry, and paper, packing and printing, have a relatively high share of leasing contracts.

Table 5.20

Leasing activities by industry type

Type of industry	Number of contracts		Contracts value ($US 000)	
	Number	%	Value	%
Petroleum, electricity and gas	1	1.3	33	0.2
Paper, packing and printing	7	9.1	1286	8.2
Iron, steel and other metal industry	3	3.9	316	2.0
Glass, ceramics and cement	4	5.2	9743	61.8
Automotive and its auxiliary	15	19.5	285	1.8
Chemical and allied industry	32	41.6	3733	23.7
Trade and marketing	3	3.9	274	1.7
Others	12	15.6	106	0.7
Total	77	100%	15776	100%

Figures given in Table 5.20 must again be treated with caution as the contract values for 13 leases in the automotive and its auxiliary, and in 'others' types of industry for 9 lease contracts, were not given; the figures in Table 5.20 were based mainly on the remaining 55 replies.

It is of interest to note that, with only two companies and four lease contracts, glass, ceramics and cement dominate over three-fifths of the total value of leases; this is because one of the leading ceramic companies financed its new manufacturing system with leasing in 1991 with about $US 9.5 million.

5.6 LEASE EVALUATION

As an alternative source of funding for any investment in new equipment, the general purpose of evaluation of a lease proposal is to ensure whether the revenue which will be generated by use of an asset is sufficient to meet its cost and to leave a reasonable profit compared to other alternatives (mainly borrowing).

As can be seen in Table 5.21, in contrast to lessors' practice, about 70% of whom indicated that they used more than one method (see Section 4.16), many of the respondent lessees claimed that they used a single evaluation method (65.0%). The other lessees in the sample (35%) stated a use of more than one method of evaluation, with the majority favouring a combination of net present value and internal rate of return.

Table 5.21

Combination of lease evaluation methods used by lessees

One method	Two methods	No method used
(a) 30.0 %	(ab) 20.0 %	(d) 5.0 %
(b) 10.0 %	(ac) 5.0 %	
(c) 25.0 %	(bc) 5.0 %	

Note:(a): Net present value; (b):Internal rate of return; (c): Payback method; (d): No formal method used

In contrast to US practice, where the most popular evaluation method is IRR (Anderson and Martin, 1977), but similar to UK practice (Hubbard, 1979; Lo 1988; Drury and Braund, 1989 and 1990), 55 % (11) of the respondent lessees (including lessees who leased or proposed to lease in 1993) indicated use of the net present value method. Other evaluation methods were IRR (35%), and payback method (35%). Only one lessee (5%) claimed no formal evaluation method was used at all.

About one-third of small and large firms, and two-fifths of medium firm lessees remarked that they were using IRR methods to compare the value of a lease with the borrowing alternative. On the other hand, whilst none of the small firms were using NPV, 40 % of medium firms and 75% of large firms used NPV. As can be seen in Table 22, small firms prefer to use the payback method for their evaluation of lease proposals to compare with alternatives.

Table 5.22

Lease proposal evaluation methods

Methods	Percentage of lessees by types			All lessees
	Small	Medium	Large	
Net present value	-	40.0	75.0	55.0%
Internal rate of return	33.3	40.0	25.0	35.0%
Payback method	66.7	40.0	25.0	35.0%
No formal evaluation method used	33.3	-	-	5.0%

Furthermore, the companies which claimed to use discounted cash flow techniques were asked what type of discount rate they use. The analysis revealed that half of the respondents indicated use of "after-tax" rate, and the other half claimed to use "before-tax" rate.

As can be seen in Table 5.23, the tendency for using the cost of borrowing in both the "before-tax" and "after-tax" rate (71.4%), indicates support for comparing lease to borrowing rather than to the purchase decision. The prevalence of using the average cost of borrowing implies that whether borrowing to purchase or lease implies similar risks. All company assets are likely to have identical risks, but usually depreciation tax savings and lease rental payments present different levels of risk. Leasing evaluation therefore needs to take all relevant factors into consideration.

Table 5.23

Discounted rate used in evaluation

	Discounted rate		**Combination of**
	Before-tax	**After-tax**	**B-T & A-T**
Average cost of capital	**14.3 %**	**-**	**14.3%**
Average cost of borrowing	**28.6%**	**28.6 %**	**57.1%**
Marginal cost of capital	**-**	**14.3 %**	**14.3%**
Marginal cost of borrowing	**7.1 %**	**7.1 %**	**14.3%**
Total	**50.0%**	**50.0%**	**100%**

Note: B-T: before-tax; A-T: after-tax

5.7 EFFECT OF 1989 INCREASE OF VAT RATE ON LEASING POLICY

In 1989, the VAT rate on cars increased from 1 to 10%, similarly the VAT rate on all commercial vehicles increased from 1 to 5%. However, in contrast, VAT on cars and commercial vehicles purchased outright remained unchanged at 15% and 10%, respectively. Although the advantage of leasing was now reduced for cars and commercial vehicles there still remained a major advantage to lease rather than buy these assets. In order to find out the immediate effect of this increase, lessees and potential lessees were asked how this increase affected their asset financing policy concerning leasing. As Table 5.24 indicates, the majority of respondents (85%) stated that there were no real effects on their leasing policy. This was the expected result. On the other hand, about 7.1% of respondents gave up acquiring this type of asset by leasing. Surprisingly, 7.1% of the respondents remarked that the increase of VAT produced a preference for leasing.

Table 5.24

Effect of VAT increase in 1989 on leasing policy

	Lessees	All companies
Leasing policy essentially unchanged	11 (84.6%)	24 (85.7%)
Renounced acquiring asset by lease	2 (15.4%)	2 (7.1%)
Brought in preference for leasing	-	2 (7.1%)
Total	13 (100%)	28 (100%)

The effect of the VAT rate increase in 1989 and afterwards seems to have affected only individuals who were now paying more VAT on acquiring private cars by leasing.

5.8 IMPACT OF LEASING FINANCE ON BORROWING CAPACITY

As a source of finance, leasing is a form of borrowing, as discussed in Chapter 2. Although previous surveys found that individual practice differed, generally leasing displaces debt on a one-to-one basis. In the present survey an additional question was also asked to determine what impact leasing finance had on the firms' borrowing capacity.

As Table 5.25 indicates, 50% of the lessees in the sample (about 63% of non-lessees) claimed that the lease expanded the firm's borrowing capacity. The remaining 50 % of lessees (19 % of non-lessees) stated that leasing neither increases nor decreases the borrowing capacity of a firm. Approximately 60% of the respondents believed that they benefited from expanding their debt capacity. Only three non-lessees, one medium and two large-sized firms, claimed that leasing caused a contraction in debt capacity. In terms of size of companies, about 90 % of small and large firms, and just over 80% of medium-sized firms, indicated that leasing either expands or causes no alteration in borrowing capacity of their firms.

Leased assets do not appear on lessees' balance sheets, therefore the off-balance sheet effect of leasing liabilities provides a kind of unseen debt that increases the companies' overall borrowing capacity. In practice, although three non-lessees claimed contraction in debt capacity, the Turkish lessees experienced either expansion or no alteration; no one claimed a contraction of capacity. As a result, although there was no clear indication that expansion of lease on debt finance directed leasing behaviour, this study supports the view that "a dollar of lease obligation uses more debt capacity than a dollar of debt capacity" or at least lease finance displaces debt on an equal basis.

Table 5.25

Impact of leasing on borrowing capacity

	Lessees	Non-lessees	All companies
Expands	10 (50.0%)	20 (62.5%)	30 (57.7%)
No alteration	10 (50.0%)	6 (18.8%)	16 (30.8%)
Contracts	-	3 (5.8%)	3 (9.4%)
Other	-	3 (5.8%)	3 (9.4%)
Total	20 (100%)	32 (100%)	52 (100%)

5.9 FACTORS AFFECTING THE LEASE DECISION

5.9.1 Reasons for leasing

Respondents were asked to rank the importance of given factors in influencing their decision to lease as compared to using other forms of financing. The question was intended to provide some limited insight as to why lessees lease and why non-lessees do not. The answers to this question are summarised in Tables 5.26 and 5.27. For both tables, respondents were asked to answer on a scale of 1 to 5, 5 being very important and 1 corresponding to minor importance; 20 different reasons to choose from were given.

Average score values for each reason for both lessees and non-lessees and the whole sample are given in Table 5.26

The responses to this question indicate, as can be seen in Table 5.26, that there are eight factors which show a median value higher than a moderate value (three) effect on respondents' leasing decisions. These are:

- Full tax-deductibility of lease rentals
- Improves flexibility of company funds
- Leasing conserves working capital
- High interest rate favours leasing
- Protects against future inflation
- Allows control on cash and credit
- Leasing is cheaper than purchasing
- Rapid growth of company business

Among these eight factors, related to tax characteristics, full tax-deductibility of lease rentals for lessees as well as non-lessees was consistently the highest. In fact, this is an obvious advantage of leasing in Turkey. However, an interesting point is that only about 55 % of those companies which leased indicated that full tax-deductibility was an important factor in the decision (score 5). On the other hand, the average score for this factor for the remaining 45% lessees was only 3.22. This would indicate that 'full tax-deductibility' is not universally perceived as being the most important factor.

Table 5.26

Reasons for leasing

Consideration factors	Lessees	Non-lessees	All respondents
Full tax-deductibility of lease rentals	4.20 (1)	4.52 (1)	4.39 (1)
Improves flexibility of company funds	3.85 (2)	3.34 (4)	3.54 (2)
High interest rate favours leasing	3.70 (3)	3.24 (5)	3.43 (3)
Protects against future inflation	3.58 (4)	3.23 (6)	3.37 (4)
Leasing conserves working capital	3.45 (6)	3.62 (2)	3.54 (2)
Allows control on cash and credit	3.10 (8)	3.39 (3)	3.27 (5)
Leasing is cheaper than purchasing	3.25 (7)	3.14 (8)	3.12 (6)
Rapid growth of company business	3.47 (5)	2.82 (11)	3.09 (7)
Competition between lessors	3.25 (7)	2.63 (14)	2.88 (10)
Reduction of risk of asset obsolescence	2.45 (13)	3.17(7)	2.88 (10)
Expected incentive use of assets	2.68 (10)	3.03 (9)	2.90 (9)
Medium-term loans not available elsewhere	2.75 (9)	3.00(10)	2.90 (9)
Expected short-term use of asset	2.42 (14)	2.27 (16)	2.94 (8)
Economic recession favour leasing	2.55 (12)	2.77 (12)	2.68 (11)
Prospect of large residual value of asset	2.60 (11)	2.67 (13)	2.64 (12)
Ease of obtaining and installing of asset	1.84 (16)	2.67 (13)	2.35 (13)
Maintenance facilities within package	1.95 (15)	2.48 (15)	2.27 (14)
The firm had insufficient capacity to pay taxes	1.74 (17)	2.23 (17)	2.04 (15)
Small company tax benefits	1.74 (17)	1.86 (19)	1.81 (16)
Tax benefits associated with geographical locations	1.40 (18)	2.10(18)	1.82 (17)

Note: Ranked order of importance in parenthesis.

In Table 5 26(a) the percentage of companies ranking each of the 20 factors as the most and the least important is given.

'Improvement of flexibility of company funds' and 'conservation of working capital' were the second most important factors. By leasing, the use of equipment is obtained without capital outlay. Thus, leasing seems to be another form of borrowing which extends the range of methods of financing. About 56% of the respondents (65% of lessees and 51% of non-lessees) counted the 'improvement of flexibility of company funds' in the lease as being of at least above average importance when considering leasing. 'Conservation of working capital' also had a significant impact on the leasing decision. Again, about 56% of respondents considered its effect is above average. If this is true, it is a valid reason for leasing, because a lease can provide 100% financing when compared to loan payments, and less cash outflow, especially during the first year. Compared to purchase, existing capital is often conserved through leasing. In fact, in an inflationary economy such as Turkey's, this factor should be expected to be one of the main reasons for leasing.

'High interest rate favours leasing' is the next important proposition to be discussed. Even if the interest rate for leasing is greater than the bank borrowing rate, leasing with fixed payments and a fixed interest rate can still reduce the financial risks which are associated with unpredictable increases in rates of interest, accordingly being an attractive proposition. Approximately 51% of the respondents (70% of lessees and 40% of non-lessees) indicated that high interest rates were either of above average or greater importance in the lease decision.

Table 5.26(a)

Most (5) and least (1) important leasing consideration factors

Consideration factors	% of companies					
	Lessees		Non-lessees		All responds	
	(5)	(1)	(5)	(1)	(5)	(1)
Full tax-deductibility of lease rentals	55	5	61	-	59	2
Leasing conserves working capital	10	10	10	-	10	4
Leasing is cheaper than purchasing	10	25	31	10	23	16
High interest rate favours leasing	25	10	14	10	18	10
Allows control on cash and credit	5	10	13	7	10	8
Improves flexibility of company funds	30	5	3	3	14	4
Protects against future inflation	16	11	3	10	8	10
Rapid growth of company business	11	5	4	11	6	9
Expected short-term use of asset	5	21	20	10	14	14
Reduction of risk of asset obsolescence	5	30	17	7	12	16
Medium-term loans not available elsewhere	20	30	4	10	10	18
Expected incentive use of assets	5	26	7	13	6	18
Competition between lessors	20	10	3	10	10	10
Prospect of large residual value of asset	10	45	7	7	9	23
Economic recession favour leasing	-	20	7	10	4	14
Ease of obtaining and installing of asset	-	63	7	27	8	40
Maintenance facilities within package	5	58	10	27	8	40
The firm had insufficient capacity to pay taxes	-	58	3	40	2	47
Small company tax benefits	-	68	4	62	2	65
Tax benefits associated with geographical locations.	5	75	7	50	6	60

With regard to the proposition that leasing was 'protecting against future inflation', about 48% of the respondents (65% of lessees and 38% of non-lessees) stated that this factor in the lease decision was equally as important as the previous. The lessee enjoys immediate use of the asset acquired through fixed lease-rental payments based on today's price which will be paid from future earnings. Thus, in an inflationary environment, a lessee can make unanticipated substantial gains in periods of rapidly rising inflation. Furthermore, because lease terms can be structured for much of the useful life of the asset, the period of a lease agreement can be considerably longer than normal bank loans which in Turkey are never longer than one year.

About 46 % of the respondents (45% lessees and 46% non-lessees) considered the importance of 'allowing control on cash and credit' as being a factor of similar importance but slightly less in magnitude than the previous two factors. Leasing with a fixed form of agreement with specified rental payments can considerably ease administrative problems and also permit greater accuracy in budget planning and forecasting of cash requirements.

One surprising result that emerged were replies regarding the 'cheapness of the leasing'. On one hand, about 51% of the respondents (65% lessees and 43% non-lessees) considered the effect of this as either great or moderate, indicating that leasing was cheaper than purchase. On the other hand, 35% (35% lessees and 35% non-lessees) of the respondents claimed that it either had no effect at all or had only a slight effect on the lease decision. One can perhaps infer that the firms involved in leasing presumably believe that 65% of the lessees' present lease contracts were cheaper, as compared with 35% of the contracts costing more.

60% of the lessees also claimed that 'rapid growth of business' effects were of over-average importance in the lease decision. In contrast, around 78% of non-lessees maintained that the above factor had no impact on the leasing decision.

It is seen that opinions between lessees and non-lessees slightly differ in relating to the above factors. On the other hand, ranking between the two groups of companies, lessees and non-lessees, for all factors, is relatively consistent and with some factors being highly correlated. The highest ranking, 'full tax-deductibility of lease rental payments' is placed at the top by both lessees and non-lessees. Similarly, 'the firms had insufficient capacity to pay taxes', 'small company tax benefits', and 'tax benefits associated with geographical location' are placed at the bottom by both lessees and non-lessees. Besides these last three factors, 'expected short-term use of asset', 'maintenance facilities within the package' and 'ease of obtaining and installing of asset' were also of significance for the large majority of respondents.

In general, perhaps not surprisingly, the above factors have a greater effect on lessees than on non-lessees. This is possibly because lessees have to give more attention and more concentration to them than non-lessees and have a greater personnel involvement with them. Only a single factor, 'rapid growth of company business', appeared to be significantly different in importance between the two groups.

Table 5.27

Ranking of leasing consideration factors by size of companies

Consideration factors	Small	Medium	Large
Full tax-deductibility of lease rentals	4.50 (1)	4.58 (1)	4.23 (1)
Leasing conserves working capital	3.71 (2)	3.59 (3)	3.56 (2)
Leasing is cheaper than purchasing	2.43 (12)	3.56 (4)	3.54 (3)
High interest rate favours leasing	3.33 (6)	3.61 (2)	3.32 (5)
Allows control on cash and credit	2.86 (9)	3.39 (6)	3.35 (4)
Improves flexibility of company funds	3.57 (5)	3.52 (5)	3.54(3)
Protects against future inflation	3.71 (2)	3.39 (6)	3.25.(6)
Rapid growth of company business	3.60 (4)	3.18 (7)	2.92 (7)
Expected short-term use of asset	2.86 (9)	3.61 (2)	2.71 (12)
Reduction of risk of asset obsolescence	2.43 (12)	3.17 (8)	2.80 (9)
Medium-term loans not available elsewhere	3.17 (7)	2.83 (12)	2.88 (8)
Expected incentive use of assets	3.14 (8)	2.94 (10)	2.79 (10)
Competition between lessors	2.67 (10)	3.11 (9)	2.77 (11)
Prospect of large residual value of asset	3.67 (3)	2.75 (13)	2.56 (13)
Economic recession favour leasing	2.57 (11)	2.89 (11)	2.56 (13)
Ease of obtaining and installing of asset	2.57 (11)	2.56 (14)	2.13 (16)
Maintenance facilities within package	1.83 (13)	2.39 (15)	2.29 (15)
The firm had insufficient capacity to pay taxes	1.57 (15)	1.83 (17)	2.33 (14)
Small company tax benefits	1.71 (14)	1.83 (17)	1.82 (17)
Tax benefits associated with geographical locations.	1.43 (16)	2.00 (16)	1.80 (18)

Note: Ranked order in parenthesis

On the basis of the companies' size, there is some difference between the three groups in the factors affecting firms' leasing decision. Whilst seven factors were identified as important and above average (indicating over moderate with a ranking of 3) by the large-sized companies, small and medium-size companies identified nine and eleven factors, respectively. Full tax-deductibility of lease rentals was considered a very important factor and was ranked in first place by all sizes of companies. Conserving working capital was ranked in second place by small and large companies, and in third place by medium-sized firms. In addition, improvement in flexibility of company funds, high interest rate favours leasing, and protection against future inflation were all considered important factors for the decision to lease for all sizes of companies.

However, as shown in Table 5.27, there are no major significant differences between medium and large companies in ranking the factors just discussed. In addition to five common factors, cheapness of leasing and allowing control on cash and credit were a common motivation between the two. Some differences between the two are that medium firms considered as important four more factors, namely 'expected short-term use of asset', 'rapid growth of company business', 'reduction of risk of asset obsolescence' and 'competition between lessors'. The only significance between them is that while 'expected short-term use of asset' was ranked in second place by medium firms, large firms did not consider it a main affecting factor.

Although there are five and six factors common between small and the other two groups of companies, there are some major differences, such as that on one hand, small companies do not believe, as the other two groups of companies, that leasing is cheaper than its alternatives. On the other hand, they considered 'prospect of large residual value of asset after lease expires', 'rapid growth of company' business', 'because medium-term loans not available elsewhere', and 'expected incentive use of asset favours leāsing' as important factors for the decision to lease. In addition, small companies believe that leasing, in the case of rapid growth of business of a company, as an additional source of finance, provides medium and long-term finance.

Whilst most of the reasons given for leasing by companies are understandable, it is difficult to see a clear motivation for 'expected intensive use of asset', and 'expected short-term use of asset' factors, given by small and medium companies, respectively. These can be particularly important for operational leasing where the lessor is normally responsible for repairs, maintenance and insurance.

The above analysis shows that large companies seem to consider taxation and a combination of conservation of smooth cash flow and capital budgeting control as the most important motivation for the lease decision, whereas medium and small firms, besides these factors, consider operational use and residual value as being of additional major importance.

5.9.2 Reasons for not using leasing

In addition to considering the reasons why companies lease, a further question was asked in the survey to try to determine why companies did not lease (and were not prepared to lease).

As can be seen in Table 5.28, many of the respondents (44%) indicated that they did not lease because they had sufficient internal cash assets to pay for all the capital assets they need. In a sense, the companies believe that internal funds are the first source to be used to finance purchase of any type of equipment.

Table 5.28

Reasons for not leasing by company size

(number (percentage) of companies)

Factors	Company types			All non lessees
	Small	Medium	Large	
Leasing more expensive than purchasing	-	4 (28.6)	4 (25.0)	8 (23.5)
Lack of awareness of advantages of leasing	2 (50.0)	4 (28.6)	1 (6.3)	7 (20.6)
Leasing is seen as a sign of financial weakness	-	2 (14.3)	-	2 (5.9)
Company has sufficient internal cash assets to meet all capital asset needs	2 (50.0)	4 (28.6)	9 (56.3)	15 (44.1)
Other reasons	-	-	2 (12.5)	2 (5.9)
Total respondents	4 (100%)	14 (100%)	16 (100%)	34 (100%)

Besides companies having sufficient cash assets, two main reasons were given for not leasing. Approximately 24% of the non-lessee companies claimed that they did not lease because 'leasing is more expensive than direct purchase'. Medium (29%) and large (25%) companies appeared to be more aware of cost differences than small firms.

Another reason, as shown in the table, as the companies indicated, was that they were not aware of leasing and they could not obtain the information they wanted. Surprisingly, about 57% of these were medium-sized companies; the corresponding figures were 29% for small and 14% for large-sized companies. More surprisingly, most of these respondents were located in the Marmara region. As indicated in Table 5.29, about 50% of the non-lease companies are located on the Black Sea coast, and 25% in Central Anatolia.

Another reason given by two companies, which had no leasing and were of medium size and located in the Marmara region, was 'leasing is seen as a sign of financial weakness'.

Several respondents, including lessees and non-lessee companies (17.5%), considered that leasing was expensive. On the other hand, over 50% of the respondents claimed that 'cheapness' was one of the main factors for leasing by companies.

Table 5.29

Reasons for not leasing by companies' location

(number (percentage) of companies)

Factors	Regions				
	Mr.	Ag.	Md.	BS	CA
Leasing is more expensive than purchasing	5 (25.0)	2 (66.7)	1 (50.0)	-	-
Lack of awareness of advantages of leasing	4 (20.0)	-	-	1 (50.0)	2 (28.6)
Leasing is seen as a sign of financial weakness	2 (10.0)	-	-	-	-
Company has sufficient internal cash assets to meet all capital asset needs	9 (45.0)	1 (33.3)	1 (50.0)	-	4 (57.1)
Other reasons	-	-	-	1 (50.0)	1 (14.3)
Total	20 100%	3 100%	2 100%	2 100%	7 100%

Note: Mr.: Marmara, Ag.: Aegean, Md.: Mediterranean, BS: Black Sea, CA: Central Anatolia.

5.9.3 Cheap source of finance

Respondents were also asked if they think leasing is a cheap source of finance and for which reason(s). The main reason (47%) given was that securing tax advantages makes leasing cheaper than other sources of finance. The other reasons given by the respondents are summarised in Table 5.30. About 20% claimed the company can acquire assets at low cost. This, with the exception of cars, is true, because while direct purchase of an asset was subject to 12% VAT, a purchase through lease only attracts 1%. VAT. Being a low risk option (12%) and low interest rate (8%) were the third and fourth factors that respondents believe make leasing cheaper.

Table 5. 30

Reasons given for cheapness of leasing by company size

(Number (percentage)of companies)

Reasons	Company types			All Respondents
	Small	Medium	Large	
A-Acquire assets at low cost	-	4 (21.0)	6 (24.0)	10 (19.6)
B-Obtain low interest rate	-	1 (25.0)	3 (12.5)	4 (7.8)
C-Favourable tax advantages	5 (62.5)	12 (50.0)	7 (29.2)	24 (47.1)
D-Low risk option	-	1 (16.7)	5 (83.3)	6 (11.8)
All options (A,B,C,D)	-	-	1 (4.0)	1 (2.0)
Others	2 (37.5)	1 (16.7)	3 (12.5)	6 (11.8)
Total	7(100%)	19(100%)	25(100%)	51(100%)

Predetermined fixed payments can reduce the risk of leasing against an unpredictable high inflation rate and increase of interest rate. But as a form of borrowing, the lease payments included a hidden interest rate which is not as obvious as with other types of borrowing. This may cause lessees to believe leasing costs less than the other sources of financing.

As can be seen in Table 5.30, the majority of small and medium-sized companies believe that tax advantages of leasing was the main reason for cheapness. But large firms, in addition to tax advantages, also believe acquiring assets through leasing costs less to the firms and reduces financial risk. Only one of the large-sized firms claimed that all four factors made leasing cheaper than other sources of finance.

5.9.4 Strategic use of leasing

As shown in Table 5.28, many of the respondents (non-lessees) preferred to use internal funds to finance all capital assets they need. Further analysis revealed that in addition to the tax consideration and the cost factor, investment can also be determined by the availability of funds. In periods when internal funds are limited, management may increase the level of debt available to the firm. The respondents were asked if debt financing became more expensive in real terms, what policy management might consider towards leasing. The analysis of the responses relating to this is shown in Table 5.31

As can be seen in the table, only about 29% of the respondents will consider use of leasing as a cheaper alternative. 14% of respondents indicated that they would not change their policy towards leasing; in other words, they would continue not to use (10.8% of non-lessees) or use (20% of lessees) leasing finance. Most of the respondents (29.8%) considered that they would increase the issue of company shares. Approximately 16% indicated that they would increase the expected profitability on capital investments.

Table 5.31

Alternative to expensive debt financing

Alternatives	Lessees	Non-lessees	All respondents
Consider increase of capital shares	3 (15.0%)	14 (37.8%)	17 (29.8%)
Raise expected profitability of capital investment	3 (15.0%)	6 (16.2%)	9 (15.8%)
Consider leasing as a cheaper alternative	7 (35.0%)	9 (24.3%)	16 (28.1%)
Leasing policy unchanged	4 (20.0%)	4 (10.8%)	8 (14.0%)
No answer	1 (5.0%)	3 (8.1%)	4 (7.0%)
Other	2 (5.0%)	1 (2.7%)	3 (5.3%)

The respondents were also asked, if tax allowances on capital investment were largely reduced, what the firm's strategy would be towards leasing. As can be seen in Table 5.32, the analysis shows that only 30% of the lessees thought that they would use leasing as a part of their financial strategy, although it is not specified precisely what form this strategy might take and the role of leasing within it. The majority (44%) indicated that they would be indifferent to leasing for limited tax saving. On the other hand, none of the companies involved in leasing stated that they no longer use lease financing.

Table 5.32

Companies policy towards leasing

Alternatives	Lessees	Non-lessees	All respondents
No longer use lease financing	-	12 (32.0%)	12 (21.1%)
Use leasing as strategic tool	6 (30.0%)	2 (5.4%)	8 (14.0%)
Be indifferent to leasing for limited tax saving	11(55.0%)	14 (37.8%)	25 (43.9%)
No answer	3 (15.0%)	7 (18.9%)	10 (17.5%)
other	-	2 (5.4%)	2 (3.5%)

The results from these analyses suggest that cost (interest rate) and taxation have a strong influence on investment behaviour and firms will tend to use the cheapest financial sources. On the other hand, lessees, who know the advantages of leasing, want to use lease finance at least as a part of a company's financial strategy in all circumstances.

5.10 DETERMINATION OF OPTIMAL LEVEL OF LEASING VOLUME

Another question attempted to find out how the companies determine their optimal lease level. The response to this question, as can be seen in Table 5.33, varied. Only two lessees (12%) stated that they used two criteria to control leasing volume, all the others used only one criterion.

The majority of lessees (53%) determined companies' leasing levels by the relation of total leasing rentals to either annual cash flow or total annual fixed charges. This clearly shows that annual volume of periodical rental payments plays an important role. This view was also supported by lessors who perceived that the fixed payment schedule was one of the main reasons for leasing (see Section 4.11).

Table 5.33

Criteria to determine optimal level of leasing

Criteria	Lessees (%)
Total leasing liabilities relative to company total liability	17.7
Total leasing liabilities relative to company total asset	5.9
Total leasing liabilities relative to company total fixed asset	11.8
Total of leasing rentals relative to total annual fixed charges	17.7
Total of leasing rentals relative to annual cash flow	35.3
Others	11.8

Furthermore, some lessees indicated that they determine their optimal level of leasing by companies' total liabilities (18%) and total assets or fixed assets (18%). About 35% of the lessees, who claimed that if tax allowances on capital investment were reduced they would still use leasing as a financial strategy, consider one of above criteria for determining their optimal level of leasing.

5.11 ACCOUNTING RECORDS

According to regulations the leased assets are recorded by the lessors and do not appear in the lessees' balance sheet. But, although the majority of lessees in the survey show that they did not record leased assets in their balance sheet, a surprisingly significant minority of lessees indicated that they did, as fixed assets. If it is true, it is difficult to understand how a company can record and depreciate an asset which is not owned by itself. As Table 5.34 shows, about 12% of the lessees also indicated that they disclose leased assets as a note in the balance sheet.

Table 5.34

Record of leased assets in balance sheet

	Number (percentage) of lessees
Do not record	13 (76.5%)
Disclose as a note in the balance sheet	2 (11.8%)
Capitalise and include with fixed assets	2 (11.8%)

At the end of the lease period, if the lessee exercises the purchase option, the ownership of the leased asset is transferred to the lessee. The lessee then records the asset as a fixed asset on the balance sheet. The lessees were asked a question relating to the value of capitalisation of the leased assets at the end of the lease period. The results from the responses are summarised in Table 5.35.

Table 5.35

Value of capitalisation of leased assets at end of lease period

	Number (percentage) of lessees
Purchase price on day of capitalisation	**1 (5.9%)**
Total value of leased payments	**3 (17.6%)**
Other (predetermined nominal value)	**13 (76.5%)**

The majority of lessees (77%) stated that they capitalise the leased assets at a predetermined nominal value. Generally, the assets are leased over their economic useful life. Therefore, at the end of the lease period, the assets have almost no book value. In the case of an asset having value, the lessee records it as a fixed asset and depreciates it over its remaining economic life. About 18% of the lessees indicated that they capitalise the asset on total value of lease payments, and the other 6% claimed that they use the purchase price on the day of capitalisation.

A question was also asked relating to how lessees record the lease payments in their profit and loss account. All lessees (100%) stated that they show them under general and administration expenses which are fully tax-deductible.

5.12 ASSESSMENT OF MANAGEMENT PERFORMANCE

A question was asked on the criteria which companies use to assess management performance regarding their financial activities. As can be seen in Table 5.36, approximately 44 % of respondents used a single criterion, and just over 50% of the respondent companies in the sample stated that they used more than one criterion. As the table shows, about 21% of the respondents indicated that they used two criteria, and 14% stated that they used three and four criteria. While only one company (lessee) indicated that it used more than four criteria, 3 companies claimed that they did not use any formal criterion, almost all criteria were used in an equal combination.

In terms of companies' size, the most preferred criterion to assess management's performance by the large firms was ratio of sales to net working capital and the liquidity position appeared to be the least preferred. In contrast to large firms, ratio of sales to net working capital was the least preferred by small and medium companies. Return on investment on fixed assets was the criterion most used by medium firms, and liquidity position and ratio of cash flow to net sales by small companies (see Table 5.37).

Table 5.36

Combination of criteria used to assess management's performance

Number of criteria used	Lessees	Non-lessees	All respondents
One criterion	10 (50.0%)	15 (40.5%)	25 (43.9%)
Two criteria	4 (20.0%)	8 (21.6%)	12 (21.1%)
Three criteria	2 (10%)	6 (16.2%)	8 (14.0%)
Four criteria	2 (10%)	6 (16.2%)	8 (14.0%)
More than four criteria	1 (5.0%)	-	1 (1.8%)
None	1 (5.0%)	2 (5.4%)	3 (5.3%)

Table 5.37

Criteria for assessing management's performance

(number(percentage)of companies)

Criterion	Company size		
	Small	Medium	Large
Return on investment on fixed assets	3 (37.5%)	10 (50.0%)	12 (41.4%)
Ratio of cash flow to net sales	4 (50.0%)	9 (45.)%)	12 (41.4%)
Ratio of sales to net working capital	2 (25.0%)	6 (30.0)	15 (51.7%)
Liquidity position	4 (50.0%)	7 (35.0%)	10 (34.5%)
Other	3(37.5%)	5(25.0%)	8(27.6%)

As the table shows, whilst the volume of the sales was the most appropriate criterion for assessing management performance by the large firms, profit on investments and liquidity (cash) were the criteria most used by the medium and small companies, respectively.

5.13 TOTAL LEASING OBLIGATIONS OF LESSEES

By the end of 1992, the total value of leasing obligations in this survey had dropped from about $US 15.8 million to $US 9.55 million, which represents figures from only 82.4% (14) of respondent lessees. In terms of the number of lease contracts, the sample covers only 1.3 % of the total leasing; in terms of value, about 2.2% of all leasing business volume between 1987 and 1992 in the lessors' survey. As can be seen in Table 5.38, replies to the survey were biased towards small lease transactions.

Table 5.38

Distribution of lease obligations by volume

Lease obligation value ($US)	Lessees		
	Small	Medium	Large
Up to 100,000	2 (14.3%)	-	3 (21.4%)
100,000-200,000	-	1 (7.1%)	2 (14.3%)
200,000-400,000	-	1 (7.1%)	1 (7.1%)
Over 400,000	-	-	4 (28.6%)
Total	2 (14.3%)	2 (14.3%)	10 (71.4%)

About 36% of the respondent lessees indicated that their lease obligations at the end of 1992 were below $US 100,000 and only about 29% of lessees' obligations were over $US 400,000. Only two lessees in the large-sized group had over $US 1 million lease obligations.

5.14 GENERAL VIEWS ON LEASING PRACTICE AND LEASING INDUSTRY

The lessees' survey final question was concerning any additional comments regarding companies' practices on the lease-purchase decision making or any other leasing-related problems.

The main ideas expressed by lessees and non-lessees are summarised as follows:

Non-lessees

- The financial managers and investors are mainly not aware of leasing and its advantages and disadvantages.
- Management generally prefer to finance their new investment with available internal funds. They do not want to use other sources unless there is no other alternative.
- Leasing is not cheaper than borrowing.
- Leasing is a source of finance for companies which have insufficient internal cash assets or which have less credibility in the financial market.

- Leasing, financing a project which qualified for incentives, has a major disadvantage because all benefits transfer to the lessor.

Lessees

- For any type of asset the leasing period should be more flexible.
- Not only financial leasing, but operational leasing should also be introduced to the leasing market and sub-leases should be permitted. This can make the leasing market more competitive and help its improvements.
- The accounting records of leased assets do not reflect the companies' real financial positions and makes it possible to misinterpret companies' financial statements.
- VAT as a tax deductible is not a real advantage of leasing for lessees.
- The current Leasing Law involves unnecessary formalities which have to be applied for a lease agreement; this discourages investors from leasing.
- The current Leasing Law has been structured in the favour of leasing companies rather than lessees.

CHAPTER SIX

Discussion of results

CHAPTER SIX

DISCUSSION OF RESULTS

6.1 INTRODUCTION

This chapter discusses the results obtained from the present research on leasing practice in Turkey from the point of view of both lessors and lessees/potential lessees.

Each of the sections of the questionnaire dealing with lessors and lessees were designed to assess performance of leasing companies and lessees in Turkey. In addition to detailed discussion of the practices of leasing, discussion is also devoted to identify the relation between lessors and lessees, together with factors affecting their decisions to lease or not to lease.

The results are discussed in two sections dealing separately with lessors and lessees.

6.2 LESSORS

Of the 38 questionnaires sent out, 16 replies were received. The responses were analysed both qualitatively and statistically in order to obtain an insight into leasing companies' past and current behaviour and their expected leasing business for the future. An attempt is also made by the author to interpret the results obtained. An element of subjective evaluation of necessity has had to be introduced

The results from the literature and questionnaire surveys for lessors are now discussed under eight major headings:

1. Nature of the lease and leasing companies.
2. Motivation for leasing.
3. Leasing activities of leasing companies.
4. Relations with customers.
5. Effect of taxes.
6. Accounting records of leased assets and leasing evaluation methods.
7. Performance of leasing companies.
8. Future prospects for leasing business.

6.2.1 Nature of lease and leasing companies

A. Nature of lease

As the research revealed, modern leasing practice in Turkey was only introduced after 1985 with the passing of the Financial Leasing Law and it is closely controlled and regulated by the UTFT. The research also revealed that there are many regulations regarding it contained in the Financial Leasing Law (No: 3226) and other public body regulations (see Section 2.2.6.1 and 2.2.6.2). The first information regarding modern leasing activities appeared in 1987.

The research further revealed that there is no distinction between financial and operational leasing practice in Turkey. All lease agreements contracted by ' *rental leasing companies*' and empowered financial institutions in Turkey are accepted as lease agreements, regardless of any distinction.

Any type of fixed or movable asset can be leased under the Turkish Financial Leasing Law. With some exceptions (see Section 2.2.6.3) involving technological factors, all leasing contracts are normally subject to a minimum term of four years. Examples of exceptions include computers and motor vehicles which have a short life as a result of obsolescence.

B. Nature of leasing companies

1. Type of leasing companies

Leasing companies in Turkey, according to their establishing, operating, and auditing, can be divided broadly into three basic types:

- Bank-affiliated and privately-owned leasing companies.
- Development and investment banks.
- Private financial institutions.

2. Leasing associations

The leasing companies operating in Turkey belong to one or other professional organisations, namely Leaseclub and FIKAD. These are associations devoted to professional advancement and development of their members and of which membership is entirely voluntary.

From the lessors' survey, Figure 4.2 (Chapter 4) shows that approximately 81 % of the sample leasing companies were members of either one of these leasing associations. The survey shows that the BA organisations in the main are members of Leaseclub, the other groups, POLCs, PFIs and D&IBs, on the other hand, in the main belong to FIKAD.

3. Market experience

The majority of leasing companies in the survey have had only short periods of experience in the leasing market. The oldest company in the sample started its leasing activities in 1987, five of the total sixteen respondents started in 1992, two in 1991, four in 1990, three in 1989, and the remaining one started in 1988.

6.2.2 Motivation for leasing.

A. Training of leasing companies' staff

The survey indicated that over 60 % of all new business in terms of leases resulted from direct personal contact. Direct contact and marketing by leasing companies to lessees play a major role in obtaining new business in the leasing industry (see Table 4.19). All types of leasing companies, PFIs, D&IBs, and BA&POLCs, indicated that their sales teams had training in marketing, with an answer of 80%. The answer to Question 8 also shows that 100% of respondents had their staff trained in financial analysis.

B. Importance of factors related to the decision to lease

1. Lessees' decision

The relative importance of the variables that enter into the leasing decision vary from company to company and for each type of asset leased. The main reasons for leasing as perceived by lessors are 'cost of finance' and 'fixed payment schedule'.

'Size of lessees' total assets to cost of item being leased' is the least important factor which influences the lessees' decision to lease or not.

2. Lessors' decision

The lessors' survey indicates that the major reasons which make leasing more attractive to the lessors than purchase are 'tax benefits' and 'lower acquired asset prices'. The survey also indicates that 'less financial risk' is the least attractive factor for lessors.

6.2.3 Leasing activities of leasing companies

A. Lease contract

The survey indicated that approximately 32 % of the respondents were using a standard leasing contract which was generally drafted to cover the general conditions to satisfy both lessors and lessees. The remaining lessors (68 %) also used a standard type leasing contract but of a more flexible nature to meet individual requirements of particular lessees.

B. Types of equipment leased

The survey revealed that there were eleven main types of assets leased during the period 1987-1992.

These are:

1. manufacturing plant and machinery,
2. textile machines,
3. computer and office equipment,
4. medical and dental equipment,
5. private and commercial vehicles,
6. heavy vehicle and construction equipment,
7. aircraft,
8. marine transportation,
9. hotels and restaurants,
10. printing and telecommunication, and
11. real estate.

Although the most important asset type leased by the sample companies was private and commercial vehicles, which accounted for about 26% of all new leases negotiated between 1987 and 1992, from 1991 it then progressively began to lose its importance. This is because, until the middle of 1991, there were very significant advantages in leasing non-commercial vehicles as VAT was only 10 % as compared with 15 % for purchase. In July 1991, VAT on car leases was increased to the same level as on car purchase and this had a significant impact on the volume of contracted car leases.

The analysis also shows that, besides automotive assets, during 1987 to 1992, the proportion of leased computer and office equipment also declined. In contrast, the proportion of leased manufacturing plant and machinery, medical appliances and construction equipment increased constantly and these sectors are still growing at the present time.

The least important category was real estate; this was because of two main reasons. First, due to tax disadvantages by which the lessor and lessee are each obliged to pay 4% up-front tax on the value of the real estate. Secondly, only 2% depreciation rate (compared with general asset depreciation rate between 6% to 25%) did not make the real estate leasing attractive.

The results of the questionnaire show that PFIs had a major interest in automotive leasing. During the survey period, PFIs contracted more than 50% of the total number of leases written for this sector. The leases for the aircraft and aerospace sector were also contracted mainly by PFIs. This sector was the second in total value of leases for PFIs, amounting to 14%. The automotive sector comes first with 54.1%.

D&IBs negotiated approximately the same volume of leases for manufacturing plant & machinery (29%) as computer and office equipment (27%).

BA&POLCs leased many different types of equipment but led the market with leases for heavy vehicles, construction and textile machinery.

The survey also showed that the lessor respondents operated on average in approximately five equipment categories from a possible maximum of eleven. However, in general, leasing companies do not specialise narrowly in particular commodity classes; about 40% of the lessors had 50 % or more of their activity in a single category of equipment. A tendency to specialise in equipment is more apparent for companies in the D&IBs group as compared with others.

The survey indicates (see Table 4.15) that manufacturing plant and machinery were the most popular items for leasing by the 86.7% of total firms in the sample which leased these items. Computer and office equipment together with commercial and private vehicles were the second most common type of asset to be leased. In contrast, aerospace items were subjects for leasing by only two lessors. Again, there was a major contrast in that approximately 96% of the business was carried out by PFIs and only 4% by BA&POLCs. This can probably be attributed to these two lessors' longer period of experience in the leasing market than others and/or because they are one of the leading lessors in the market by their total leasing volume. Again:

- they have a particular expertise in aircraft leasing,
- they have a direct contact or agreement with the manufacturer or dealer.

These two lessors dominate not only in the sample's aircraft leasing but also the total aircraft leasing volume in Turkey, amounting to 81% and 85% of total aircraft leasing in Turkey in 1991 and 1992, respectively.

C. Size of leases

The analysis shows that individual items of equipment leased between 1987 and 1992 by the sample companies ranged in value from \$US 580 to \$US 23.5 million. The average value of leases contracted in this period was \$US 120,945.

Certain lessors specialised in large value (\$US 13.5 million) lease transactions while others specialised in leases of less than \$US 25,000. The differences in lease values accepted by different companies depended much on the nature of the organisations themselves; the average lease value of development and investment banks was approximately \$US 750,000, whereas the average lease value contracted by PFIs and BA&POLCs was just over \$US 100,000. It seems that the nature of companies reflects the lease size; whilst D&IBs lessors prefer to finance large value investment projects, the others may have no special preference to choose a project.

From the analysis it is also evident that about 20% of the leasing companies, mainly bank-affiliated, dominate the leasing market in Turkey. This can probably be attributed to the large number of branches which can reach a wide range of customers. On the other hand, PFIs and D&IBs lessors have relatively few branches in Turkey. For this reason bank-affiliated lessors can more readily contact a large number of potential customers and are relatively free of geographical constraints.

D. Investment incentives for leasing

The result of the survey showed (see Table 4.34) that in terms of number, approximately 66% of the investment incentives projects were financed by the D&IBs lessors; in terms of value, this was 69%. These figures for PFIs and BA&POLCs lessors were: in terms of number of contracts, 4% and 30%; and in terms of value, 17 % and 14 %, respectively.

The survey also shows that about 60 % of the total D&IBs' leasing contract volume were incentives projects, for PFIs the corresponding figure was only 7%, and for BA&POLCs was only about 4%.

The results showed that investment incentive projects, which were in specified geographical locations and/or specified economic sectors determined by government, were mainly financed by D&IBs lessors. The reason for these large discrepancies are possibly because

- D&IBs take an additional financial risk to finance these projects (in the case of lessees' failure all tax benefits transferred to the lessors must be returned with interest) in order to benefit from investment allowances' tax advantages, and/or
- big project investors believe that development and investment banks are the most suitable financial institutions which were initially established to finance these types of projects.

E. Seasonal leasing business volume

The survey indicated (see Table 4.27, Chapter 4) that the quarterly distribution of leasing contracts for the years 1991 and 1992 varies from lessor to lessor. The lowest percentage of total leasing business was transacted in the first quarter and, similarly, the largest percentage was contracted in the last quarter for 1991, as well as for 1992. This gap occurs possibly because firstly, traditionally the first quarter (winter) is generally quiet for business, especially for construction and marketing; secondly, 4 of 13 leasing companies (for 1992) started their leasing business after September 1992. Business in the second and third quarters of the years was spread more or less evenly.

F. Funding leasing activities

The surveyed companies reported that 56 % of the total funds for leasing activities were raised from ordinary share capital. About 22% was raised through bank borrowing, mainly from parent banks. It was also reported that about 12% of lease activities were financed by profit-loss sharing accounting sources.

The PFIs companies claimed that 90.7% of their leasing business funds come from clients' profit-loss sharing accounts.

D&IBs responded that 78.4% of their leasing activities were financed by their share capital. They also issued bonds in the capital market which financed a further 13% of their leasing activities.

BA&POLCs companies reported that about 48% of their leasing activity was financed by equity capital and 38% by bank borrowings, mostly raised through parent banks. They also claimed that issuing debentures, amounting to about 10%, was also one of the main sources of finance for their leasing activities.

6.2.4 Relations with customers

A. Type of customer

The leasing companies surveyed reported that about 98% of the value of leases in the period 1987-1992 was negotiated in the private sector. About 63% of the leasing companies did at least 78% of their business for the private sector. 37% of the lessors negotiated leasing contracts with the public sector however, accounting for less than 2% of the value of all leases negotiated during the same period. None of the lessors in the sample reported leasing contracts with mixed-sector companies.

None of the lessors in the D&IBs group in the sample had any leasing contracts with the public sector. Of the six lessors who signed leasing contracts with public sector companies, five were in the BA&POLCs group and one in the PFIs group. Of the nine lessors constituting the BA&POLCs group, five had leases with public sector companies.

It is seen accordingly that the main clients for leasing companies were privately-owned companies rather than public companies.

B. Geographical location of customers

The survey indicated that the Marmara had the highest concentration of lessees. About 82% of the sample leasing companies' customers (lessees) are located in this region. The smallest proportion of leases is with companies located in East and South-east Anatolia, which accounted for only 0.6%.

This is because Marmara is the most developed region where investors prefer to invest and where the vast majority (88%) of the sample lessors' head offices are located.

The survey also reveals that the lessors in the group BA&POLCs generally regarded themselves as potentially supplying the whole of the national market. On the other hand, like D&IBs lessors, the vast majority of BA&POLCs lessors' customers were also in the Marmara region. PFIs serve companies mainly located in Central Anatolia within Turkey.

This can again probably be attributed to the concentration of the lessors' branches in the regions, which makes investors and people aware of leasing, and gives easy contact with customers. Lessors also seek a high rate of return on their investment, thus regional stability, development grants and investment allowances are a major inducement for leasing business in the regions. Therefore, in contrast to other regions, instability and the low investment in East Anatolia and South-east Anatolia are the main reasons for only 0.6% of lease companies being located in these regions. (A total of 18% and 4% of the investment incentives were for both regions in 1991 and 1992, respectively; however, in the Marmara region these were significantly higher, 31.2% and 55.5%).

Consequently, it can be said that leasing in developing regions only represents a small percentage of total leasing activities and variations depend very much on level of general investment and incentives.

C. Influences acting on customers' choice of equipment supplier

37.5% of the leasing companies responded that they attempted to influence the lessees in their choice of equipment supplier during the leasing agreement process.

Leasing companies which attempt to influence the lessees to choose a particular supplier did so under different possible conditions, such as before a lessee decided on a supplier or when a lessee asks for advice. This is generally as an ancillary service to the customer rather than an attempt to direct them towards particular suppliers with whom lessors have special arrangements. Only three of the companies surveyed had agreements with certain manufacturers or dealers that they would recommend them to their clients.

D. Required information

Lessors generally seek a high rate of return on their investment, thus regional stability, taxation law, regional development grants and tax investment incentives for special industries are a major inducement for leasing business.

All the companies ranked financial stability of client to be of primary importance. 50% of the total companies ranked expected economic life of leased assets as being primarily importance and only 31% ranked expected rate of asset depreciation as being of primary importance.

E. Repeat business

The survey indicated that 81.2 % of the value of all business undertaken by the sample companies during the period 1987-1992 was with new lessees; however, only 18.8% of total asset value was repeat business. While PFIs companies' repeat business with previous lessees was 18.8% and BA&POLCs' 25.3%, D&IBs did only 7.5% of their total leasing business with previous customers. The volume of repeat business with lessees gives an indication of the extent of customer satisfaction and loyalty.

It seems that PFIs with 18.8%, and BA&POLCs with 25.3 % performed reasonably well. But on the other hand, these figures may be related to the early establishment of one of the leading lessors in the market within these groups whilst lessees had few options to choose a lessor from. This also may reflect different classes of clients; while D&IBs dealt with mainly large value leases, the others dealt mainly with small value leases for assets such as cars, computers and office equipment.

F. Lease business marketing

The survey results showed that over 60 % of all new business resulted from direct personal contact, with the lessors' marketing staff and sales team making initial contact with their clients.

The survey however showed that 18 % of all new leasing transactions came through recommendations of manufacturing companies. Parent banks and their branches and general advertising also play important rôles in marketing. New business stemming from parent banks and their branches was about 8%, with 6% arising from other general advertising.

For each of the groups, direct contacts and activities of their sales teams consistently come first. But, while D&IBs and BA&POLCs rely heavily on companies' direct contact and their sales teams, PFIs, besides direct personal contact, also rely on general advertising, recommendations of manufacturers and repeat business customers (15%). This would perhaps indicate that PFIs' lessees are more satisfied with their lessors than other lessees with theirs. More surprisingly, although PFIs' lessors stated that they have no agreements with manufacturer and dealers and they did not attempt to influence the lessees in their choice of equipment supplier, about 19% of their customers come through recommendation of manufacturers. It can also be said that PFIs have better relations with both manufacturers and dealers.

The survey also indicated the importance of parent banks and their branches in making initial contact with lessees among the D&IBs' and BA&POLCs' lessors.

6.2.5 Effect of VAT on leasing business

A. <u>General effect</u>

The VAT tax advantages to lessors (with the exception of cars) in leasing agreements is reflected in the result of the survey indicating that leasing is more attractive than purchasing.

B. Effect of VAT rate increase

1. Immediate effect on leasing volume

79% of respondents who were in the leasing business in 1989 stated that the increase in the rate of VAT on cars and commercial vehicles did not affect their business volume significantly. This might be because, although the VAT rate increased from 1% to 5% and to 10% for cars and commercial vehicles, respectively, there were still major advantages in leasing rather than in buying these assets. On the other hand, 21% of the respondents estimated that their leasing volume was about 10-20 % less in 1989 than they expected originally.

2. Later effects on leasing volume

All lessors indicated that they believed the VAT increase in 1989 caused a decrease in their 1990, 1991 and 1992 total lease volume of around 21%, 26% and 24% for all companies on average, respectively; however, these falls varied from company to company between 10% to 50%. It seems the most affected lessors were in the PFIs group. This is because over 50% of this group's lessor business was for motor vehicles.

3. Effects on other factors

The surveyed leasing companies reported that the increase in the rate of VAT caused a slight increase in :

- cost of funding,
- competition in the market
- risk in leasing activities.

6.2.6 Accounting record and leasing evaluation methods

A. Decision on expected economic life of leased assets

The survey showed that lessors used one or more different methods for deciding on an asset's economic life. Around 67% used legislation, 33% made a decision themselves, 13% allowed the lessee to decide. Again, 13% relied on the figure given by the supplier company. Approximately 67% of the respondents relied on only one of the above criteria; approximately 33% used two or more.

B. Depreciation methods used

About 62% of lessors in the sample survey indicated that they used the straight-line depreciation method. Only about 13 % of the respondents stated that they were using the accelerated method. The rest, 25 %, preferred either the straight-line or the accelerated method according to the type and period of the economic life of the asset.

C. Recording leased assets in companies' balance sheets

All (100%) respondent leasing companies in the survey stated that they recorded leased assets in their balance sheet as a fixed asset.

D. Methods used for evaluation of lease proposals

Approximately 31% of leasing companies reported that they used a single evaluation method, and the other 68.8% in the sample used more evaluation techniques.

While 82% of the companies reported that they used the IRR technique to evaluate lease proposals, about 56% and 38% companies stated that they used the payback period and NPV, respectively, IRR and payback method being the most popular combination.

6.2.7 Performance of leasing companies

A. Assessments of companies' performance with regard to their leasing activities

75 % of leasing companies indicated that they used more than one (two-three-four) criterion to assess their company performance with regard to their leasing activities. It is reported that 68.8% of the companies used a net profit after-tax, and 50% used a total value of assets of new contracts criterion. The other criteria used by the leasing companies were total receivable rental income during the year (43.8%), total number of leased contracts (31.2%), and net profit before-tax (25%).

It appears that each leasing company has its own criteria to assess company performance, particularly related to company's age, market experience and expectations.

B. Leasing activity's profit to total leasing turnover

The leasing companies reported that their profit to total leasing turnover for the years 1987-1992 was 1/4 or less. Only one lessor in the PFIs group stated a profit ratio to total turnover of 1/1.

C. Companies' growth

25 % of the leasing companies said that they increased their leasing companies' branches from 9 to 26 in total. 50 % of the respondents reported that they also increased their staff, in total, from 224 to 788. Again, about 63 % of respondents said that they increased their capital approximately 540% after they commenced their leasing business, from TL 137.5 billion to TL 876 billion. This probably reflects leasing companies' expectation of growth in the market and reaching new classes of clients, and therefore to increase their proportion of business in the lease market.

6.2.8 Plans and expectations for future leasing activities

A. Leasing companies' expectations of leasing market in general

The survey reflected that the future of the leasing business in Turkey in the view of lessors was promising. Approximately 19% of the lessors in the sample predicted the future of the leasing industry in general will be 'very good', and about 69% believed that the future of the leasing marketing in general is 'good'. Only 12% of the respondents believed that the leasing market will be uncertain.

B. Leasing companies' expectations of leasing market in companies' particular sector

12.5% of respondents predicted the future of their own particular sector will also be 'very good', and 81.2% believed that the future of the leasing market in their particular sector will be 'very good'. Only 6.3% of the respondents believed that the leasing market for their own sector will also be uncertain.

As mentioned above, the increase of companies' branches, staff and capital are also evidence that the future of leasing in Turkey will be bright.

C. Companies' plans for future leasing activities

Evidence from the survey of lessors suggested that there will be a market increase in the demand for leasing business. About 81% of the surveyed leasing companies said their future leasing business volume would increase between 30% to 600 % in relation to the previous year.

Regarding plans for future leasing business, only 6.3% of the companies reported that it will stay on the same course. The remaining 92.7% companies said that they were looking to extend their leasing business transactions.

6.3 LESSEES

Of the 250 questionnaire sent out, 57 usable replies were received. The responses were analysed both subjectively and statistically in order to identify the behaviour of companies with respect to leasing, to try to understand why companies lease, and to present a general overview of leasing practice.

The results from the questionnaire survey for lessees are now discussed under five major headings :

1. Companies' perceptions and attitudes towards leasing.
2. Motivation and factors which affect lessees' decision to lease.
3. Leasing activities of companies.
4. Leasing evaluation methods and accounting records of leased assets.
5. Assessments of companies' performance, expectations and general views on leasing practice.

6.3.1 Companies' perceptions and attitudes towards leasing

A. How management regard lease decision

Approximately 50% of the companies responded that they consider a leasing decision is a financial decision, therefore an acquisition decision was considered separately from a financing decision; about 40% of respondents considered that a lease decision is a combination of both investment and financial decisions, thus those companies consider both decisions simultaneously. Only 7% of the respondents reported the leasing decision as purely an investment decision. This finding is slightly different from empirical studies in the UK. For example, Fawthrop and Terry (1975, 63%,), Hubbard (1979,71%) and Drury and Braund (1990, 86%) noted that a majority of respondents considered the leasing decision is a financing decision and should be taken separately. But on the other hand, academics including Beechy (1969), Ofer (1976), Lewellen (1972), McConnell and Schallheim (1983), Bower (1973),and Nunnally et al. (1991), agree that the lease decision is a combination of investment and financing decisions.

None of the lessee companies in the sample regarded a lease decision as an investment decision. About 65% of lessees also considered it as a combination of both decisions, with the remaining (35%) lessees in the sample considering that there are two separate decisions, and leasing is a financial decision.

B. Management attitudes towards leasing

With regard to management attitudes, the survey indicated that 52.6% of the companies' management were 'neither for nor against' leasing; they held no opinion at all, and 36.8% of companies reported that their management were 'in favour' of leasing. Only 3.5% of companies said that their management were 'against' leasing.

C. How companies made aware of leasing

The survey indicated that the most influential factor, at 40.4%, in creating awareness of leasing, was direct mailing from lessors to companies and the leasing companies' marketing staff, the 'leasing companies'. The companies also reported that the other most common factors which induced them to be aware of leasing were 'advertising in the financial and trade press', 'financial institutions', and 'conferences and seminars', at 36.8%, 31.6%, and 23%, respectively. 'Lessees' themselves (5.3%) seem to have only a very small impact on the awareness of leasing. It clearly seems that there are many ways which leasing companies used to make the public aware of leasing.

D. How companies choose a suitable lessor for their lease proposals

88.2 % of the companies which had signed lease contract(s) between the years 1987 and 1992 stated that they chose a suitable lessor from several different detailed lease proposals from different lessors. Only about 6% of the lessees said that they had only one lessor who financed all the types of equipment they needed.

6.3.2 Motivation and factors affecting companies' lease decision to lease or not to lease

A. Effect of 1989 VAT rate increase on companies' leasing policy

85% of the companies indicated that the increase of the VAT rate on cars and commercial vehicles, if acquired through lease, did not really affect their leasing policy. Again, this is because, although the VAT rate increased from 1% to 5% and to 10%, for cars and commercial vehicles, respectively, there were still major advantages to lease rather than buy (15%) these assets. On the other hand, about 7.1% of companies reported that they gave up acquiring this type of asset by leasing, and 7.1% of the respondents remarked that the increase of VAT produced a preference for leasing.

B. Impact of leasing on companies' borrowing capacity

50% of the lessees in the survey (about 63% of non-lessees) claimed that the lease expanded the firm's borrowing capacity and the remaining 50 % of lessees (19 % of non-lessees) stated that leasing neither increases nor decreases the borrowing capacity of a firm. Only about 6% of companies in the survey claimed that leasing caused a contraction in debt capacity.

This agrees with Nunnally et al.(1991) who maintain that leasing appears to displace a greater quantity of debt capacity on the lessee's balance sheet than it provides. The survey indicated that the off-balance sheet effect of leasing liabilities provides a kind of unseen debt that increases the companies' overall borrowing capacity. The survey also revealed that the Turkish lessees experienced either expansion or no alteration. As a result, although this is not obvious, the study supports the view that "a dollar of lease obligation uses more debt capacity than a dollar of debt capacity" or at least lease finance displaces debt on an equal basis.

C. Factors affecting companies' decision to lease

The companies' survey indicated that there were eight main factors which had an effect on companies' leasing decisions. These are:

- Full tax-deductibility of lease rentals
- Improves flexibility of company funds
- Leasing conserves working capital

- High interest rate favours leasing
- Protects against future inflation
- Allows control on cash and credit
- Leasing is cheaper than purchasing
- Rapid growth of company business

Among these eight factors, related to tax characteristics, full tax-deductibility of lease rentals for lessees as well as non-lessees was consistently the highest. This is a clear advantage of leasing, because lease rental payments, as expenses, are fully tax-deductible, but in the case of borrowing, only interest payments are tax-deductible. However, the survey also revealed that 'full tax-deductibility' was not universally perceived as being the most important factor. In addition to 'full tax-deductibility of lease rentals' and 'conserving working capital', 'improvement in flexibility of company funds', 'high interest rate favours leasing', and 'protection against future inflation' were also considered important factors for the decision to lease for all companies. Although every country has its own economic and financial environment which affect the lease decision, this finding shows some similarity with other studies in the UK and the USA. For example, the results of the Anderson and Martin (1978) USA study, based on a survey of 180 US, corporations which were asked to score 40 possible reasons for leasing, ordered 'leasing provides 100% deductibility of costs' in first, and 'leasing frees working capital for other uses' in third places (Tomkins at al., 1979, pp. 96-97). The empirical studies in the UK also indicated that 'conservation of working capital' (Sykes, 1976, 76%; Hull and Hubbard, 1980, 54%; and Drury and Braund, 1990, 65%) and 'tax consideration' were attractive factors for a large proportion of firms surveyed (Mayes and Nicholas, 1988, 50%; Drury and Braund, 1990, 89%). But on the other hand, the importance of 'high interest rate favours leasing', 'protects against future inflation' and 'allows control on cash and credit' contrasts with Hull and Hubbard (1980) and Drury and Braund (1990). This possibly reflects Turkey's unstable economic situation and unpredictable increases of inflation and interest rates.

On the other hand, the companies surveyed considered that 'the firms had insufficient capacity to pay taxes', 'small company tax benefits', and 'tax benefits associated with geographical location' were the least important factors affecting companies' lease decision. This is because there are no different tax brackets according to size of companies which object to paying 25% corporation tax in Turkey, and also there are no specific tax advantages for leasing in specified geographical regions.

The survey also indicated that large-sized companies considered taxation and a combination of conservation of smooth cash flow and capital budgeting control as the most important motivation for the lease decision, whereas medium and small firms, besides these factors, considered operational use and residual value as being of additional major importance.

D. Why companies do not lease

44% of the non-lessee companies indicated that they did not lease because 'they had sufficient internal cash assets' to pay for all the capital assets they need. The companies believe that internal funds are the first source to be used to finance purchase of any type of equipment. Besides companies having sufficient cash assets, two other main reasons were also given for not leasing: 'leasing is more expensive than direct purchase' and 'they were not aware of leasing'. About 24% of the non-lessee companies claimed that they did not lease because 'leasing is more expensive than direct purchase'. This finding contrasts somewhat with lessee companies which claimed that they leased assets because 'leasing is cheaper than purchase'. The reason for such a conclusion might be:

- Companies used inappropriate evaluation to compare the alternatives,
- companies borrow at prime interest rates which makes outright purchase cost less than leasing,
- companies generalised from a special case requirement where there was high risk involved which was reflected in leasing times being unduly excessive.

About 21% of companies indicated that they did not lease because 'they were not aware of leasing'. This obviously shows that leasing has not been publicised enough so that companies could obtain the information they wanted.

Around 6% of the companies also claimed that they did not lease because 'leasing is seen as a sign of financial weakness'.

E. Strategic use of leasing

As indicated above, 44% of the non-lessee companies preferred to use internal funds to finance all capital assets they need. Further, the survey indicated that about 24.3% of the non-lessees would consider use of leasing as a cheaper alternative in periods when internal funds are limited, and if debt financing became more expensive in real terms; 37.8% of the non-lessees considered that they would increase the issue of company shares. Only 10.8% of non-lessees indicated that they would not change their policy towards leasing; in other words, they would continue not to use leasing finance. Approximately 16% of companies indicated that they would increase the expected profitability on capital investments.

The survey also indicated that, if tax allowances on capital investment were largely reduced, 30% of the lessees and 5.4% of non-lessee companies thought that they would use leasing as a part of their financial strategy. 55% of lessees and about 38% of non-lessees indicated that they were indifferent to leasing for limited tax saving. While none of the companies involved with leasing stated that they would no longer use lease financing, 32% of non-lessees said that they would not use lease financing.

This conclusion revealed that cost and taxation have a strong influence on investment behaviour and lessees who know the advantages of leasing wanted to use lease finance at least as a part of a company's financial strategy.

F. Way companies regard leasing as a cheap source of finance

47% of the respondent companies believed that securing tax advantages makes leasing cheaper than other sources of finance. This, with the exception of cars, is true, because while direct purchase of an asset was subject to 12% VAT, acquirement of an asset through lease only attracts 1% VAT. Furthermore, rental payments of all types of leased assets are fully tax-deductible.

About 20% claimed the company can acquire assets at low cost and 8% believed that a low interest rate makes leasing cheaper than other sources of finance. This possibly reflects the predetermined fixed payments which can reduce the risk of leasing against an unpredictable high inflation rate and increases of interest rate. But as a form of borrowing, the lease payments included a hidden interest rate which is not as obvious as with other types of borrowing. This may cause lessees to believe leasing costs less than other sources of financing.

G. How companies determine their optimal level of leasing

The survey showed that companies had used various ways of controlling the leasing volume which reflected their companies' financial strategy. Only 12% of the companies stated that they used two criteria at the same time to control leasing volume, the remaining 88% of the companies reported that they used only one criterion.

About 35% of the lessee companies surveyed stated that they determined companies' leasing levels by the relation of total leasing rentals to annual cash flow. This might tend to suggest that companies' payments plans and level of total outflow with total income have a major influence on the level of leasing volume. Also, it might suggest that, as one of the major reasons to be involved in leasing, the fixed payment of leasing which allows control on cash and credit also affects companies' optimal level of leasing.

Furthermore, 18% of lessees indicated that they determine their optimal level of leasing by companies' total leasing liabilities to total liabilities, 11.8% to total fixed assets and 5.9% to total assets. This might show that, although leased assets are shown neither as fixed assets or liabilities in lessees' balance sheets, lessees consider leasing as borrowing and account for it while formulating their corporate strategy.

6.3.3 Leasing activities of lessees

A. Types of leased assets

The lessees' survey indicated that four main types of equipment were leased by companies. These were:

- Manufacturing plant and machinery.
- Computer and office equipment.
- Vehicles.
- Heavy vehicles and construction equipment.

This might be because these were the most available types of assets in the available lease market and the most competed types for the majority of leasing companies in Turkey (See Table 4.15, Chapter 4). These types of assets also constituted about 85% and 83% of total lease contracts in Turkey in 1991 and 1992, respectively.

The survey showed that whilst 41% of the lessees leased only one type of equipment, the remaining 47% and 12% of the lessees stated that they leased two and three types of equipment, respectively.

The survey also revealed that 59% of lessees acquired vehicles through leasing, 47% of lessees acquired manufacturing plant and machinery, and the same percentage of lessees stated that they acquired computer and office equipment through lease agreements.

It can be concluded that, besides manufacturing plant and machinery (including textile machinery), medical equipment and, in contrast to the lessors' findings, computer and office equipment, were also becoming increasingly popular in the leasing market.

B. Size of lease contracts

The companies surveyed reported that throughout the six years 1987-1992, they acquired new assets which had a total value of about $US 1,454 million. During the same period, the total value of the leases contracted by the 17 lessees in the survey was around $US 15.8 million, with an average value of about $US 287,000. This was only 1.1% of the total assets acquired by the 57 sample companies.

1. Number of lease contracts

The survey indicated that during the survey period of the six years 1987-1992, about 30% of respondent companies signed a total of 77 lease agreements. While 75.3% of these lease contracts were negotiated by large-sized companies, 19.5% were negotiated by medium, and 5.2% were contracted by small-sized companies. This may reflect managerial sophistication and awareness of alternative methods of financing asset acquisition in large companies rather than the other groups.

2. Value of lease contracts

60 % of the lessees surveyed said that they limited their involvement in leasing to not more than 8% of new asset acquisition. About 12% of the lessees, on the other hand, acquired all (100 %) of their new assets through leasing, and 6% of them acquired 88 % of their new assets through leasing during the survey period.

Leases reported in this study were either mainly small or medium-sized leases. The survey showed that about 29% of individual leasing contracts were valued between $US 26,000 and $US 50,000, 33% between $US 50,000 and $US 100,000, and 24% of contracts between $US 100,000 and $US 200,000. Each of the remaining 15% of contracts was valued over $US 200,000.

The survey revealed that only 6.0% of the total assets acquired by lessee companies during the six years 1987-1992 were financed by leasing. As mentioned above, large firms tend to make more use of leasing than medium and small-sized companies. In terms of value, 90% of the total lease contracts negotiated between 1987 and 1992 were executed by large firms. Again, this may reflect sophistication and awareness of alternative methods of financing by managers in large companies.

C. Types of companies and industries involved in leasing activities

The survey indicated that 100% of companies involved in leasing activities were within the private sector. None of the public or mixed companies in the sample negotiated a single leasing agreement during the period 1987-1992. This obviously reflects differences in practice between private and public companies. Whilst private sector management have freedom, flexibility, and can make quick decisions which can adapt the company to changeable economic conditions, bureaucratic procedure and controls, the lack of skilled managers, and planning and administration, generally make public companies clumsy in making adequate and feasible decisions.

The survey also indicated that seven types of industries, as shown below, were involved in leasing activities. The relatively greater importance of leasing, among seven, was in the chemical and glass, ceramics, and cement industries. The survey also revealed that the automotive and its auxiliary industry, and paper, packing and printing had a relatively high proportion of leasing contracts.

- Petroleum, electricity and gas
- Paper, packing and printing
- Iron, steel and other metal industry
- Glass, ceramics and cement
- Automotive and its auxiliary
- Chemical and allied industry
- Trade and marketing

6.3.4 Lessees' evaluation of lease proposals and accounting record of leased assets

A. How lessees evaluate lease proposals

65.0% of the lessees claimed that they used a single evaluation method and 35% of the lessees in the survey stated that they used more than one method of evaluation.

In contrast to US practice, where the most popular evaluation method is IRR, similar to UK practice, 55 % of the Turkish lessees (including lessees who leased or proposed to lease in 1993) indicated that they used the net present value method for their evaluation of lease proposals to compare with alternatives. IRR by 35%, and payback method by 35%, were other methods used by Turkish lessees. Only 5% of the lessees claimed that they did not use any formal evaluation method. The majority of lessees reported that they preferred to use a combination of net present value and internal rate of return.

The survey indicated that whilst medium-sized firms used IRR, NPV and payback methods in the same proportion for their evaluation of lease proposals to compare with alternatives, the majority of large firms (75%) preferred to use NPV, and small firms (67%) preferred to use the payback method. The reason for small companies preferring the payback period might be because it is simple and easy to understand and to implement.

B. How lessees record leased assets in their balance sheet

In accordance with legislation which does not require a leased asset record in the balance sheet, 76.5% of lessees in the survey reported that they did not record leased assets in theirs, but about 12% of lessees indicated that they did, as fixed assets. 12% of the lessees also indicated that they disclosed leased assets as an additional note in the balance sheet.

C. How lessees show lease payments in their profit/loss account

100% of lessees surveyed stated that they show the lease payments under general and administration expenses in their profit and loss account, which are fully tax-deductible.

D. If leased assets capitalised at end of lease period what value is used ?

77% of the lessee companies stated that they capitalise the leased assets at a predetermined nominal value at the end of the lease period. About 18% of the lessees indicated that they capitalise the asset on total value of lease payments, and the other 6% claimed that they used the purchase price of assets on the day of capitalisation.

6.3.5 Assessment of companies' performance

A. How companies assess management performance

The survey indicated that companies surveyed used the following criteria to assess management performance.

- Return on investment on fixed assets.
- Ratio of cash flow to net sales.
- Ratio of sales to net working capital.
- Liquidity position.

44 % of companies said that they used a single criterion, and just over 50% of the companies surveyed stated that they used more than one criterion, and almost all criteria were used in an equal combination.

The survey also revealed that whilst the majority of large firms preferred the criterion 'ratio of sales to net working capital' to assess management performance, medium-sized companies mainly preferred 'return on investment on fixed assets', and small companies used 'liquidity position' and 'ratio of cash flow to net sales'.

CHAPTER SEVEN

Conclusions and recommendations

CHAPTER SEVEN

CONCLUSIONS AND RECOMMENDATIONS

7.1. INTRODUCTION

The main objective of this chapter is to summarise conclusions and recommendations derived from the present study. Recommendations are made in two categories. The first category contains suggestions for improving leasing practice in Turkey, and the second category areas where further research could usefully be carried out.

7.2 CONCLUSIONS

The objective of this study has been to provide some understanding of the current state of leasing in Turkey: which type of leasing companies are in the lease market, which type of firms are likely to be involved in leasing, what type of assets are leased, what reasons affect companies' decision to lease, how they finance their leasing activities, and what companies' attitudes are towards leasing. In accordance with the objectives of this study, the main findings of the present research can be summarised as follows:

1. Leasing is a relatively recent phenomenon in Turkey, but is now growing rapidly and approximately 40 active lessors account for about 2.5% of total fixed investment financing in the country. As compared with other countries Turkey is still well below the world average of 10%.

2. Regarding trends since leasing was practised in Turkey in 1987 it has grown annually at an average rate of 100%. If this rate were to be maintained Turkey should reach world average values within the next five years.

3. In Turkey there is no distinction between types of leases as in other countries. All lease agreements contracted by leasing companies and empowered financial institutions are accepted as a lease (financial rental) agreement.

4. The present research has demonstrated that in Turkey no single type of leasing asset has dominated the leasing market. The main type of assets subject to lease agreements are motor vehicles, computer and office equipment, and manufacturing plant and machinery. The least important category was real estate.

5. The research indicates that the Turkish leasing industry is highly controlled and regulated by legislation, such as the Financial Leasing

Law (No: 3226) and other public body regulations. In addition, leased assets are required to be insured for the full term of the lease.

6. The research indicates that the Turkish government consider leasing to be strategically important for future economic development.

7. The national market is somewhat fractured by size of transactions, region and asset types. The main barrier to entering the lease market is access to finance.

8. 20% of all leasing companies, mainly bank-affiliated, dominate the market in Turkey.

9. Bank-affiliated leasing companies (established by commercial banks) are entering the lease market which clearly shows that financial institutions have taken steps to protect themselves from competition or to benefit from this activity.

10. The research indicates that the trend in the major leased assets is for change from motor vehicles to manufacturing plant and machinery.

11. The research indicates that attraction of new leasing business is mainly by personal contact and not other formalised marketing routes.

12. In Turkey most leases are subject to standard lease contract. The present research however indicates that the majority of lessors would prefer a leasing contract tailored to particular needs.

13. The present research shows that individual items of assets leased between 1987 and 1992 ranged in value from $US 580 to $US 23.5 million. The average value of leases contracted in this period was $US 120,945.

14. The research indicates that investment incentives projects were mainly financed by the D&IBs lessors rather than PFIs and BA&POLCs lessors.

15. The research indicates that the PFIs companies' leasing business funds mainly come from clients' profit-loss sharing accounts. D&IBs and BA&POLCs companies' leasing activity was financed by their share capital and by bank borrowings.

16. The research showed that about 98% of the value of leases in the period 1987-1992 was negotiated in the private sector.

17. The research indicates that the Marmara has the highest concentration of lessees, with the smallest concentration in East and South-east Anatolia.

18. The research indicates that only a small percentage of the leasing companies attempt to influence their lessees in their choice of equipment supplier.

19. The results of research indicates that, in order of importance, financial stability of client, expected economic life of leased assets, and expected rate of asset depreciation are important factors in the leasing business.

20. Repeat business is uncommon, varying between 7.5% for D&IBs and 25% for BA&POLCs.

21. The present research showed that the increase in the rate of VAT in 1989 in Turkey on cars and commercial vehicles did not adversely affect leasing until 1991 when there was a major drop for cars for PFIs.

22. The research shows that lessors used more than one method for depreciation over an asset's economic life but the most commonly used was the straight-line depreciation method.

23. The IRR method is the most common method used to evaluate the lease proposals.

24. The research survey indicates that the main reason for leasing is 'full tax-deductibility'. This is followed by 'improvement in flexibility of company funds' and 'conserving working capital'.

25. The research indicates that the main reasons given for companies not acquiring assets by leasing were 'they have sufficient internal cash assets' for direct purchase, secondly 'leasing is more expensive than direct purchase', and surprisingly, the third reason, 'they were not aware of leasing'.

26. When choosing a lessor, lessees did take advantage of the wide range of alternatives available.

27. The research survey indicates that leasing companies in Turkey perceived future prospects to be very good and leasing is playing an important role for the industrialisation of the country.

7.3 RECOMMENDATIONS FOR IMPROVING LEASING PRACTICE IN TURKEY

In order to promote and further develop leasing in Turkey recommendations arising from the research are:

1. In order to encourage real estate leasing, at the end of the lease term, if the purchase option is exercised by the lessee, the transaction price should be exempt from corporation tax. Up-front tax on real estate, as exercised in Spain, should not be required when it is sold in the first sale.

2. In order to introduce sub-leasing and operational leasing in Turkey, not only leasing companies and empowered financial institutions, but also manufacturing companies, should be given the right to lease. Because in an operational lease the lessors are normally responsible for repairs and maintenance, and their profit comes partly from their ability to re-lease the asset in the future, the lessor needs to be technically knowledgeable about the leased assets.

3. In order to make leasing known to the public, to have first-hand information and to facilitate interchange of ideas between academics and professionals, conferences and seminars should be arranged not

only in a particular region, such as Istanbul, but in every other part of Turkey. These should also enable formulation of proper leasing policies in Turkey and help to direct investors' interest towards the practice of leasing.

4. Leasing legislation should be structured not only by government and leasing companies' views but lessees' views should also be represented. Therefore, leasing law should not be structured for the advantages of either party, but for industry generally.

5. VAT concessions on leasing transactions, especially for manufacturing plant and machinery and for new technology equipment, such as computers, should continue.

6. Since the Turkish bank system is not willing to supply medium and long-term loans for investment projects, the government should create a financial market which provides medium and long-term credit to lessors to promote industrial development.

7. With non-reporting of leased assets, a true picture of lessees' liabilities is not presented. Thus, leasing gives misleading results in the evaluation of the company's financial structure, particularly for new borrowings and cash flow policies of a company. Therefore, it is recommended that all leased assets should be disclosed on the lessees' balance sheets as a footnote.

8. The current Leasing Law involves unnecessary formalities which have to be applied for a lease agreement, and discourages investors from leasing; this should be reviewed.

9. The authority should relax the existing rules and regulations for import of capital assets by leasing companies. In addition, in order to take advantage of the latest technology, the limitation of $US 25000 on annual rental payments to the foreign leasing company in cross-border leasing should be lifted.

10. In order to create fair competition in the leasing market between the leasing companies, the 11% tax on the interest which bank-affiliated and privately-owned leasing companies pay for loans they obtain to finance their leasing activities should be removed.

11. In order to remove financial barriers to enter the lease market, the obligation of the establishment of a leasing company as a form of joint-stock company should be relaxed and limited liability companies should also be permitted to exercise leasing transactions. Manufacturing companies especially should be empowered and encouraged to enter the lease market.

12. At present all tax concessions accruing to the lessee are transferred to the lessors, if the project is entitled to benefit from incentives. Under this system, if a lessee defaults in industrial activity the lessor must repay the liability and benefits already received for incentives. It would have been more appropriate if the lessee was entitled to benefit from these (tax allowances and developing region grants). By doing this, the companies which are planning to invest in this type of project would be encouraged to finance it with leasing. Furthermore, the lessor company which benefits from incentives will be free from the above financial risk.

13. Leasing companies are required to report to the Treasury certain details of each and every leasing contract (see Appendix G) they have signed. Hence, what is needed to be known about leasing in Turkey is known only by the Treasury, which is not disclosed. This information should be made available to the public on demand to promote improved leasing practice and research.

14. For the benefit of industry, there needs to be more co-operation between government and leasing companies. A single leasing association for all leasing companies could assist in promoting good leasing practice.

7.4 RECOMMENDATIONS FOR FURTHER RESEARCH

It is recommended that further research be carried out in the following areas:

1. There is a need to examine in detail what might be changed in the lease decision from the standpoint of lessees, after the corporation tax was reduced from 46% to 25%.

2. The lease decision, especially for lessees, is complicated. In-depth analysis of the lease proposal, and comparison with its alternatives (especially borrowing) on the demand side, are needed. The interviews should also be applied for further research.

3. There is a need to determine the effect of leasing on the investment behaviour of companies with an examination of the direct relation with total investment in Turkey.

4. A survey similar to the present study should be carried out separately for each of the regions, including East and South-east Anatolia.

5. Consideration should be given to examine all types of lessors separately, in relation to their customers, market structure, and performance.

6. Studies are also required to identify what changes have occurred in the lessees' decision after the first lease agreement has expired and the effect of the salvage value of assets on their decision.

7. There is a need for studies to ascertain the relation between types of leased assets and length of the lease period, and to evaluate cost-benefits.

8. There a need to develop a leasing evaluation model for both lessors and lessees.

9. A survey similar to the present study should be carried out for cross-border leasing.

10. A study of whether the objectives of privatisation of state economic enterprises can be fulfilled by leasing rather than by privatisation is recommended.

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APPENDICES

APPENDIX A

Covering letters and lessors' questionnaire

DEPARTMENT OF INDUSTRIAL TECHNOLOGY

UNIVERSITY OF BRADFORD

Dear Sir,

31/03/93

Mr Recep Karabulut is carrying out research for his Ph.D under my direct supervision. The subject of his research is the formulation and assessment of suitable strategic leasing policies for industry in Turkey. It is necessary for Mr Karabulut, as part of his research, to identify the perceptions, attitudes and preferences of senior management in both private and public sectors of industry with regard to leasing.

To further this research we have produced a questionnaire which is enclosed with this letter. It is being sent to selected organisations drawn from the Public and Private sectors in Turkey.

In order to assist us, I would be pleased if you could spare the odd half hour or so to complete the questionnaire. By doing so, not only would Mr Karabulut be helped with his research but hopefully the research itself will have some long-term benefit for Turkey. If you are interested we will be pleased to let you have a summary, to comment on, of our initial findings when we have carried out a preliminary analysis of the returned questionnaires.

Yours faithfully,

Dr A Z Keller

UNIVERSITY OF BRADFORD WEST YORKSHIRE BD7 1DP UK

TEL 01274 384239 TELEX 51309 UNIBFD G FAX 01274 391333

DEPARTMENT OF INDUSTRIAL TECHNOLOGY

UNIVERSITY OF
BRADFORD

Dear Sir,

April 1993

I am carrying out a research project at Bradford University, Department of Industrial Technology to assess leasing practice in Turkey. The main objectives of the study are to identify leasing practices in Turkey concerning legal and financial aspects, type of assets and their accounting, motivation and the factors influencing the leasing decision, and to assess the nature and extent of past, current, and future leasing activities.

In order to identify the above aspects, two separate questionnaires have been designed for lessors and lessees/potential lessees. A copy of the lessors' questionnaire which includes questions concerning your company entity, leasing activities and your personal views, is enclosed.

I would be very grateful if you, or some responsible persons in your company, would take time to complete the questionnaire. If you would not be able to give an accurate answer to any question, a reasonable approximate/estimate answer will be sufficient.

All information received will, naturally, improve our understanding of Turkish leasing practice in the industry, and will be treated with absolute confidentiality, and will not be disclosed to a third party.

I would be grateful if you would kindly complete and return the questionnaire in the pre-addressed envelope at your earliest convenience.

Yours faithfully,

Recep KARABULUT

UNIVERSITY OF BRADFORD WEST YORKSHIRE BD7 1DP UK

TEL 01274 384239 TELEX 51309 UNIBFD G FAX 01274 391333

LESSORS' QUESTIONNAIRE

PLEASE TICK OR CIRCLE LETTER / NUMBER WHICH IS MOST APPLICABLE

1. On what date was your leasing organisation founded ?

(d) ____/(m) _____/ 19____

2. Your leasing entity is:

A. An independent lessor. ☐

B. A subsidiary of a Turkish bank. ☐

C. A subsidiary of a foreign bank. ☐

D. A subsidiary of a Turkish manufacturing company. ☐

E. A subsidiary of a foreign manufacturing company. ☐

F. Other (please specify). ☐

____

____

G. In the cases of **D** or **E** please list main manufacturing activities.

____

____

3. If your leasing company is a subsidiary of a bank or a manufacturing company;

Your parent company is:

____

4. Your leasing company is

A. A member of Leaseclub ☐

B. A member of FIKAD ☐

C. A member of following organisation (please name)

____

D. An independent organisation ☐

5. Do you provide financial services other than leasing ?

Yes ☐

No ☐

If your answer to Question 5 is YES, please list other main financial services you supply

A. ______________________________

B. ______________________________

C. ______________________________

D. ______________________________

6. If your Answer to Question 5 is YES, please indicate as a percentage the approximate ratio of your leasing to total financial activity.

A. Contributes less than 25 % ☐

B. Contributes 25 % - 50 % ☐

C. Contributes 50 % - 75 % ☐

D. Contributes more than 75 % ☐

7. What form do your leasing contracts take ?

A. A standard format. ☐

B. A standard format customised to individual contracts. ☐

C. No standard format. ☐

D. Other (please specify).

____

____

8. Have your leasing sales teams had training in any of the following fields?

A. Financial Analysis. ☐

B. Accounting. ☐

C. Tax. ☐

D. Marketing. ☐

9. What are the major reasons in your opinion that make leasing more attractive than purchase to the lessor ?(Please rank 1-5. 1= most attractive, 5= least attractive)

A. Lower acquired asset prices. __

B. Less demand on cash asset. __

C. Reduced cash flow requirements. __

D. Less financial risk. __

E. Tax benefits to the lessor. __

F. Others (please specify) __

____

10. Does your company attempt to influence the lessee in his choice of equipment supplier ?

Yes ☐

No ☐

If your answer is YES, when ?

A. Before lessee has decided on a supplier. ☐

B. When your company is asked for advice. ☐

C. When your company has agreements with a supplier which has particular equipment that lessee wants. ☐

D. When you know better offer is available elsewhere. ☐

E. Other (please specify)

____

____

11. What indirect information does your company require before entering into a leasing agreement?

A. Expected life of the equipment ☐

B Lessee's financial stability. ☐

C. Expected rate of depreciation of item. ☐

D. Location of lessee. ☐

E. Other information (please list). ☐

____

____

12. Which of these criteria does your company use in formulating a lease offer?

A. Internal Rate of Return. ☐

B. Net Present Value. ☐

C. Payback method. ☐

D. No formal method is used. ☐

E. Other methods (please specify)

____

____

13. Please rank on a scale 1-5 (1= essential, 5= no importance) the importance of the following factors in influencing decisions of lessees

A. Cost of finance. ____

B. Availability of funds. ____

C. Size of lessee's total assets to cost of item being leased ____

D. Fixed repayment schedules. ____

E. Finance risk reduction. ____

F. Others (please specify). ____

____

____

14. What do you think was the immediate effect of the tax (VAT) increase in 1989 on your leasing business ?

A. Increased volume. ☐

B. Decreased volume. ☐

C. No significant change. ☐

D. In case of A or B please give an approximate percentage

Increase ________%

Decrease ________%

15. What effects has the 1989 VAT increase had on the following ? (1 = large decline, 2 = small decline, 3 = no major effect, 4 = small increase, 5 = large increase)

	1	2	3	4	5
A. Competition in your leasing market .	☐	☐	☐	☐	☐
B. Deferred tax provisions.	☐	☐	☐	☐	☐
C. Costs of funding.	☐	☐	☐	☐	☐
D. Margins of your leasing deals.	☐	☐	☐	☐	☐
E. Risks on your leasing activities.	☐	☐	☐	☐	☐

16. What do you estimate your company's leasing turnover would now be (percentage increase/decrease) , if there had been no VAT increase in 1989 and subsequently ?

	<u>INCREASE</u>		<u>DECREASE</u>
A.	________%	1990	________%
B.	________%	1991	________%
C.	________%	1992	________%

17. What was the approximate ratio of your leasing activity profit to total leasing turnover for the following years ?

	1:4 or less	1:2	1:1	2:1	3:1	4:1 or over
A. 1987	☐	☐	☐	☐	☐	☐
B. 1988	☐	☐	☐	☐	☐	☐
C. 1989	☐	☐	☐	☐	☐	☐
D. 1990	☐	☐	☐	☐	☐	☐
E. 1991	☐	☐	☐	☐	☐	☐
F. 1992	☐	☐	☐	☐	☐	☐

18. What is the approximate percentage of tax free leasing of your total leasing?

A. 0 - 25% ☐

B. 25 - 50% ☐

C. 50 - 75% ☐

D. 75 - 100% ☐

19. How many leasing contracts have you signed in any of the years listed below ? Will you please give the number of contracts and approximate total value of contracts.

	NUMBER OF CONTRACTS	TOTAL VALUE OF CONTRACTS(Million TL.)
A. 1987	_______	_________
B. 1988	_______	_________

C. 1989 ______ ________

D. 1990 ______ ________

E. 1991 ______ ________

F. 1992 ______ ________

20. What percentage of your annual leasing turnover was

	1987	1988	1989	1990	1991	1992
A. With new customers?	____%	____%	____%	____%	____%	____%
B. With existing customers?	____%	____%	____%	____%	____%	____%
	100%	100%	100%	100%	100%	100%

21. What percentage of your annual turnover do you believe you acquired as a result of:

	1987	1988	1989	1990	1991	1992
A. Direct personal contact.	____%	____%	____%	____%	____%	____%
B. General advertising	____%	____%	____%	____%	____%	____%
C. Contacts made at conferences and seminars.	____%	____%	____%	____%	____%	____%
D. Introduction by manufacturers.	____%	____%	____%	____%	____%	____%
E. Introduction by other lessees.	____%	____%	____%	____%	____%	____%

F. Introduced by other lessors.____%____%___%____%____%____%

G. Other sources (please list)

__________________ _____%____%____%____%____%____%

__________________ _____%____%____%____%____%____%

22. What percentage of your annual leasing funds came from the following sources:

	1987	1988	1989	1990	1991	1992
A. Equity capital.	____%	____%	____%	____%	____%	____%
B. Bank loans (short-term borrowing)	____%	____%	____%	____%	____%	____%
C. Bank loans (long-term borrowing)	____%	____%	____%	____%	____%	____%
D. Debentures.	____%	____%	____%	____%	____%	____%
E. Tax allowances.	____%	____%	____%	____%	____%	____%
F. Retained earnings.	____%	____%	____%	____%	____%	____%
G. Other sources (please list)						
__________________	____%	____%	____%	____%	____%	____%
__________________	____%	____%	____%	____%	____%	____%
	100%	100%	100%	100%	100%	100%

23. As percentages of your annual leasing turnover, please indicate the main industrial areas for your leasing activities.

	1987	1988	1989	1990	1991	1992
A. Manufacturing plant and machinery	___%	___%	___%	___%	___%	___%
B. Textile machinery.	___%	___%	___%	___%	___%	___%
C. Computer and office equipment.	___%	___%	___%	___%	___%	___%
D. Medical equipment.	___%	___%	___%	___%	___%	___%
E. Automotive.	___%	___%	___%	___%	___%	___%
F. Aerospace.	___%	___%	___%	___%	___%	___%
G. Shipping.	___%	___%	___%	___%	___%	___%
H. Heavy vehicles and construction equipment.	___%	___%	___%	___%	___%	___%
I. Other industries						
________________	___%	___%	___%	___%	___%	___%
________________	___%	___%	___%	___%	___%	___%
	100%	100%	100%	100%	100%	100%

24. Can you please give indications, as a percentage of total leasing turnover, of the geographical distribution of your activities.

	1987	1988	1989	1990	1991	1992
A. Marmara.	___%	___%	___%	___%	___%	___%
B. Aegean.	___%	___%	___%	___%	___%	___%

C. Mediterranean.	___%	___%	___%	___%	___%	___%
D. Black Sea.	___%	___%	___%	___%	___%	___%
E. Mid-Anatolia.	___%	___%	___%	___%	___%	___%
F. East Anatolia.	___%	___%	___%	___%	___%	___%
G. South-east Anatolia.	___%	___%	___%	___%	___%	___%
H. Other areas outside Turkey (please list)						
____________	___%	___%	___%	___%	___%	___%
____________	___%	___%	___%	___%	___%	___%
	100%	100%	100%	100%	100%	100%

25. What percentage of your leasing turnover is with customers in the following sectors

	1987	1988	1989	1990	1991	1992
A. Public sector.	___%	___%	___%	___%	___%	___%
B. Private sector.	___%	___%	___%	___%	___%	___%
C. Public / private sector.	___%	___%	___%	___%	___%	___%
	100%	100%	100%	100%	100%	100%

26. What volume of your total leasing turnover has been with "investment incentive certificate holder firms" for the years listed below ? Will you also please indicate the annual number of contracts for this type of lessee.

		Number of Contracts	Value of Assets Leased (Million TL.)
A.	1987	________	___________
B.	1988	________	___________
C.	1989	________	___________
D.	1990	________	___________
E.	1991	________	___________
F.	1992	________	___________

27. Can you please identify the largest and the smallest values of items leased in the years 1987-1992 and the nature of the items leased.

	Item Leased	Value of Item (Million TL.)
A. 1987	(Largest)____________________________	___________
	(Smallest)____________________________	___________
B. 1988	(Largest)____________________________	___________
	(Smallest)____________________________	___________
C. 1989	(Largest)____________________________	___________
	(Smallest)____________________________	___________
D. 1990	(Largest)____________________________	___________
	(Smallest)____________________________	___________

(Largest)______________________________ ____________

E. 1991

(Smallest)______________________________ ____________

(Largest)______________________________ ____________

F. 1992

(Smallest)______________________________ ____________

28. How were your quarterly leasing volumes distributed in the years 1991 and 1992?

	1991	1992
A. 1st Quarter	____%	____%
B. 2nd Quarter	____%	____%
C. 3rd Quarter	____%	____%
D. 4th Quarter	____%	____%
	100%	100%

29. Which criteria do you use to assess your company's performance with regard to its leasing activities ?

A. Total number of new contracts. ☐

B. Total value of assets of new contracts. ☐

C. Total receivable rental income during the year. ☐

D. Net profit before tax. ☐

E. Net profit after tax. ☐

F. Other (please specify). ☐

____

30. Is the expected economic life of the equipment being leased decided by

A. Lessee. ☐

B. Supplier company. ☐

C. Your company. ☐

D. Legislation. ☐

E. Other criteria (please specify). ☐

____

31. Which depreciation methods does your company use ?

A. Straight- line method. ☐

B. Accelerated method. ☐

C. Other methods (please specify). ☐

____

32. Where does your firm show leases in its Balance Sheet ?

A. Fixed Assets. ☐

B. Debtors. ☐

C. Other headings (please specify). ☐

____

____

33. In the last 5 years has your company

	YES
A. Merged with another leasing company ?	☐
B. Merged with a non-leasing company ?	☐
C. Taken over a leasing company ?	☐
D. Taken over a non-leasing company ?	☐
E. Been subject of a take-over by a leasing or non-leasing company?	☐

F. In the cases of either B or D what is the main activity of companies you have taken over or merged with. ?

____

____

G. Been the subject of an unsuccessful take over, (Please give brief details).

____

____

34. In the last 5 years has your company

	NO	IF YES	
		FROM	TO
A. Reduced the number of its branches ?	☐	_____	_____
B. Increased the number of branches ?	☐	_____	_____
C. Reduced the number of staff ?	☐	_____	_____
D. Increased the number staff ?	☐	_____	_____

E. Decreased volume of equity capital ? ☐ _____ _____

F. Increased volume of equity capital? ☐ _____ _____

G. Increased use of computers ? ☐ _____ _____

35. How do you see the future of the leasing market generally in Turkey ?

A. Very good ☐ B. Good ☐

C. Unchanged ☐ D. Very uncertain ☐

E. Bad ☐ F. Very bad ☐

G. Please comment and give reasons for your choice above.

____

____

36. How do you see the future of the leasing market in your own particular sector ?

A. Very good ☐ B. Good ☐

C. Unchanged ☐ D. Very uncertain ☐

E. Bad ☐ F. Very bad ☐

G. Please comment and give reasons for your choice above.

____

____

37. What are your company's plans for future leasing activities?

A. Expansion. ☐

B. Contraction. ☐

C. No change. ☐

D. Cessation. ☐

E. Other (please specify). ☐

____

____

38. What do you anticipate your future leasing turnover to be relative to your 1992 volume? Please indicate whether - or + or same.

A. 1993______% (-) (+) (same)

B. 1994______% (-) (+) (same)

C. 1995______% (-) (+) (same)

39. Are there any actions you believe the Turkish government could and should take to improve leasing activities? If so will you please identify them and give reasons?

40. Are there any significant factors, in your opinion which can affect future demand for leasing in Turkey. If so will you please identify and give reasons why you believe these factors will be important ?

41. Can you please complete the following.

Name of company:

Name of person completing questionnaire:

Position:

Tel:

Fax:

Date:

Thank you very much for your co-operation in completing this questionnaire. It would be very much appreciated if a copy of your company's latest published accounts could be returned with the questionnaire.

Questionnaire to be returned to:

Recep KARABULUT,
P/G Research Student,
Department of Industrial Technology,
The University of Bradford,
W. Yorkshire BD7 1DP,
ENGLAND

APPENDIX B

Covering letters and lessees' questionnaire

DEPARTMENT OF INDUSTRIAL TECHNOLOGY

UNIVERSITY OF
BRADFORD

Dear Sir, 25/05/93

Mr Recep Karabulut is carrying out research for his Ph.D under my direct supervision. The subject of his research is the formulation and assessment of suitable strategic leasing policies for industry in Turkey. It is necessary for Mr Karabulut, as part of his research, to identify the perceptions, attitudes and preferences of senior management in both private and public sectors of industry with regard to leasing.

To further this research we have produced a questionnaire which is enclosed with this letter. It is being sent to selected organisations drawn from the Public and Private sectors in Turkey.

In order to assist us, I would be pleased if you could spare the odd half hour or so to complete the questionnaire. By doing so, not only would Mr Karabulut be helped with his research but hopefully the research itself will have some long-term benefit for Turkey. If you are interested we will be pleased to let you have a summary, to comment on, of our initial findings when we have carried out a preliminary analysis of the returned questionnaires.

Yours faithfully,

Dr A Z Keller

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DEPARTMENT OF INDUSTRIAL TECHNOLOGY

UNIVERSITY OF
BRADFORD

Dear Sir,

May 1993

I am carrying out a research project at Bradford University, Department of Industrial Technology to assess leasing practice in Turkey.

As you are aware, leasing practice was introduced in 1985 with Financial Leasing Law No: 3226 to create an alternative mechanism for medium and long-term funding requirements for capital projects and consumer goods manufacturing where these were for the future economic development of Turkey. Today, approximately 2% of all new annual fixed investment is financed by over 30 leasing companies, the first of which started in 1987.

The main objectives of the study are to identify leasing practices in Turkey concerning legal and financial aspects, type of assets and their accounting, motivation and the factors influencing the leasing decision, and to assess the nature and extent of past, current, and future leasing activities, together with problems of leasing.

In order to identify the above aspects, two separate questionnaires have been designed for lessors and lessees/potential lessees. A copy of the lessees' questionnaire which includes questions concerning your company entity, leasing activities and your personal views, is enclosed.

I would be very grateful if you, or some responsible person in your company who is closely concerned with leasing, would take time to complete the questionnaire. Even if your company does not engage in leasing activities, you will still find some questions to answer such as why your company does not lease, so please complete every relevant questions. If you would not able to give an accurate answer to any question, a reasonable approximate/estimate answer would be sufficient.

All information received will be treated with absolute confidentiality and will not be disclosed to a third party.

I would be grateful if you would kindly complete and return the questionnaire in the pre-addressed envelope at your earliest convenience.

Yours faithfully,

Recep KARABULUT

UNIVERSITY OF BRADFORD WEST YORKSHIRE BD7 1DP UK

TEL 01274 384239 TELEX 51309 UNIBFD G FAX 01274 391333

LESSEES' QUESTIONNAIRE

PLEASE TICK OR CIRCLE LETTER/NUMBER WHICH IS MOST APPLICABLE

1. Your company is:

A. A public company. ☐

B. A private company. ☐

C. A mixed company. ☐

2. The number of employees in your company is:

A. 1 - 99 employees. ☐

B. 100 - 999 employees. ☐

C. 1000 - 4999 employees. ☐

D. 5000 - 10000 employees. ☐

E. More than 10000 employees. ☐

3. Which sector does your company belong to ?

A. Manufacturing. ☐

B. Transport. ☐

C. Financial and banking. ☐

D. Distributive and service (please specify). ☐

____

____

E. Others (please specify). ☐

____

4. Has your firm paid tax in any of the financial years listed below ?

		YES	NO
A.	1987	☐	☐
B.	1988	☐	☐
C.	1989	☐	☐
D.	1990	☐	☐
E.	1991	☐	☐
F.	1992	☐	☐

5. What is your management's attitude towards leasing ?

A. Management is in favour of leasing. ☐

B. Management is opposed to leasing. ☐

C. Management attitude is neutral. ☐

D. Other attitudes (please specify). ☐

____

6. How does your management regard a decision to lease ?

A. As an investment decision. ☐

B. As a financial decision. ☐

C. As both (A and B). ☐

D. Other (please specify).

____

____

7. How is your company made aware of leasing ?

A. By advertising in financial and trade press. ☐

B. By conferences and seminars. ☐

C. By financial institutions. ☐

D. By manufacturing companies. ☐

E. By lessors. ☐

F. By other lessees. ☐

G. Others (please specify). ☐

____

____

8. Which methods does your company use to choose a lessor ?

A. Recommendation from an equipment supplier. ☐

B. Detailed financial assessment of proposals from different lessors. ☐

C. Company has only one lessor for all equipment. ☐

D. Other (please specify). ☐

____

____

9. What is approximate value of assets acquired in the years listed below ?

VALUE (TL. Million)

A. 1987. ____________________

B. 1988. ____________________

C. 1989. ______________

D. 1990. ______________

E. 1991. ______________

F. 1992. ______________

10. Have you signed leasing contracts in any of the years listed below ? If you answer YES for any of the years, please give the number of contracts and approximate total value.

		YES	APPROXIMATE NUMBER OF CONTRACTS	TOTAL VALUE (TL. Million)
A.	1987	☐	______	__________
B.	1988	☐	______	__________
C.	1989	☐	______	__________
D.	1990	☐	______	__________
E.	1991	☐	______	__________
F.	1992	☐	______	__________

11. Please indicate the proportion of each of the following types of equipment leased by your company for each year listed below (total value of particular leased asset relative to total value of all leased assets in a year).

	1987	1988	1989	1990	1991	1992
A. Manufacturing plant and machinery.	____%	____%	____%	____%	____%	____%
B. Textile machinery.	____%	____%	____%	____%	____%	____%

C. Computer and office equipment.
____%____%____%____%____%____%

D. Medical equipment. ____%____%____%____%____%____%

E. Automotive. ____%____%____%____%____%____%

F. Aerospace. ____%____%____%____%____%____%

G. Shipping. ____%____%____%____%____%____%

H. Heavy vehicles and construction equipment.
____%____%____%____%____%____%

I. Other industries

____________________ ____%____%____%____%____%____%

____________________ ____%____%____%____%____%____%

100% 100% 100% 100% 100% 100%

12. Which of these criteria does your company use to assess management performance?

A. Return on investment on fixed assets. ☐

B. Ratio of cash flow to net sales. ☐

C. Ratio of sales to net working capital. ☐

D. Liquidity position. ☐

E. Other (please specify) ☐

____

____

13. What impact would leasing finance have on the borrowing capacity of your firm ?

A. It would expand. ☐

B. It would not alter. ☐

C. It would contract. ☐

D. Other (please specify). ☐

____

____

14. How does your company record leased assets on its Balance Sheet ?

A. Does not record. ☐

B. Discloses as a note to the balance sheet ☐

C. Capitalises and includes with fixed assets. ☐

D. Other (please specify). ☐

____

____

15. If your company capitalised the leased assets, what value is used ?

A. Purchase price on the day of capitalisation. ☐

B. Total value of the lease payments. ☐

C. Others (please specify) ☐

____

____

16. How does your company shows lease payments on its profit and loss account ?

A. General and administration expenses. ☐

B. Research and development expenses. ☐

C. Others (please specify) ☐

____

____

17. Which evaluation method does your company use to determine whether leasing is economic ?

A. Internal Rate of Return. ☐

B. Net Present Value. ☐

C. Payback method. ☐

D. No formal evaluation method used. ☐

E. Other (please specify) ☐

____

____

18. What rate is selected for your discounted cash flow calculation ?

	Before Tax	After Tax
A. Average cost of capital.	☐	☐
B. Average cost of borrowing.	☐	☐
C. Marginal cost of capital.	☐	☐

D. Marginal cost of borrowing. ☐ ☐

E. Company set specific rate. ☐ ☐

F. Other (please specify) ☐ ☐

____

____

19. If you think leasing is a cheap source of financing, this is because leasing

A. Can acquire assets at low cost. ☐

B. Obtain low interest rates. ☐

C. Can secure favourable tax advantages. ☐

D. Is a low risk option. ☐

E. Other (please specify) ☐

____

____

20. How did the increase of VAT tax in 1989 affect your asset financing policy in 1990-1991 ?

A. Renegotiation of existing lease contracts. ☐

B. Equipment bought in preference to leasing. ☐

C. Renounced asset acquisition by lease. ☐

D. Leasing policy essentially unchanged. ☐

E. Other (please specify). ☐

____

21. If debt financing becomes more expensive in real terms, will your firm

A. Consider increasing the issue of shares. ☐

B. Raise expected profits rate for capital investments. ☐

C. Consider leasing as a cheaper alternative. ☐

D. Leasing policy unchanged. ☐

E. Other (please specify).

____

____

22. If capital tax allowances were largely reduced, would your firm

A. No longer use lease financing. ☐

B. Still use leasing as a strategic tool. ☐

C. Be indifferent to leasing for limited tax savings. ☐

D. Other (please specify). ☐

____

____

23. Please describe the effect of the following factors on your decision to lease by using the scale (1-5)

1= great 2= moderate 3= fair 4= slight 5= none

A. Full tax deductibility of lease rentals ___

B. Leasing is cheaper than purchasing. ___

C. The firm has insufficient capacity to pay taxes. ___

D. Small company tax benefits. ___

E. Tax benefits associated with geographical location. ___

F. Allows control on cash and credit. ___

G. Leasing conserves working capital. ___

H. Because medium-term loans are not available elsewhere. ___

I. Reduction of risk of asset obsolescence. ___

J. Expected short-term use of asset. ___

K. Expected intensive use of asset. ___

L. Maintenance facilities within the package. ___

M. Ease of obtaining and installing capital asset. ___

N. Prospect of large residual value of asset after lease expires. ___

O. Improved flexibility of company funds. ___

P. Protects against future inflation. ___

Q. High interest rates favour leasing. ___

R. Economic recession favours leasing. ___

S. Competition between lessors. ___

T. Rapid growth of company business. ___

U. Special tax benefits for company (please describe). ___

_______________________________________ ___

_______________________________________ ___

V. Other benefits (please describe).

_______________________________________ ___

24. Which of the following types of equipment are leased or are going to be leased by your company:

	Currently leased	Proposed to lease
A. Manufacturing plant and machinery.	☐	☐
B. Textile machinery.	☐	☐
C. Computer and office equipment.	☐	☐
D. Medical equipment.	☐	☐
E. Automotive.	☐	☐
F. Aerospace.	☐	☐
G. Shipping.	☐	☐
H. Heavy vehicles and construction equipment.	☐	☐
I. Other (please specify).		
____________________________	☐	☐
____________________________	☐	☐

25. How is your optimal level of leasing determined ?

A. Total leasing liabilities relative to company total liabilities. ☐

B. Total leasing liabilities relative to total company assets. ☐

C. Total leasing liabilities relative to company total fixed assets. ☐

D. Total of leasing rentals relative to annual fixed charges. ☐

E. Total of leasing rentals relative to annual cash flow. ☐

F. Others (please specify). ☐

____

26. If your company does not lease, this is because:

A. Leasing is more expensive than direct purchase. ☐

B. Lack of awareness of advantages of leasing. ☐

C. Leasing is seen as a sign of financial weakness. ☐

D. Company has sufficient internal cash assets to meet all capital asset needs. ☐

E. Other reasons (please specify). ☐

____

____

27. Your total leasing obligation is (TL million)__________________

26. We would appreciate any additional comments regarding your company's practices on lease-purchase decision making, or any other leasing-related problems encountered by your company which have not been addressed above.

27. Can you please complete the following

Name of company:

Name of person completing questionnaire:

Position:

Tel:

Fax:

Date:

Thank you very much for your co-operation and for completing this questionnaire. A copy of your company's latest published accounts would be much appreciated if it could be returned with the questionnaire.

Questionnaire to be returned to:

Recep KARABULUT,
P/G Research Student,
Department. of Industrial Technology,
The University of Bradford,
Bradford BD7 1DP,
ENGLAND

APPENDIX C

First follow-up letter

DEPARTMENT OF INDUSTRIAL TECHNOLOGY

UNIVERSITY OF
BRADFORD

Dear Sir,

June 1993

About two months ago, I wrote to you about the study I am doing into leasing practice in Turkey and enclosed a copy of the questionnaire. Unfortunately, I have not yet received your completed questionnaire.

Although a reasonable number of questionnaires have been returned, I believe that you and others who as the managers of leasing companies are responsible for the guidance and improvement of the leasing industry in Turkey may have different views or different experience which will help us to understand fully leasing practice in Turkey.

In case my other correspondence did not reach you, I am again sending you a copy of the questionnaire. I hope you or the most appropriate person in your company can devote half an hour from your precious time to complete the questionnaire.

Your valuable contribution to this study will be greatly appreciated.

Yours faithfully,

Recep KARABULUT

UNIVERSITY OF BRADFORD WEST YORKSHIRE BD7 1DP UK

TEL 01274 384239 TELEX 51309 UNIBFD G FAX 01274 391333

APPENDIX D

Second follow-up letter

DEPARTMENT OF INDUSTRIAL TECHNOLOGY

UNIVERSITY OF BRADFORD

August 1993

Dear Sir,

About four months ago I wrote to you asking you to complete a questionnaire about leasing practice in Turkey. But so far I have not yet received any reply from your company.

In case my other questionnaires did not reach you, you will find another copy of it is enclosed. I hope you can devote about half an hour to completing the enclosed questionnaire yourself or pass it to the most appropriate person in your company and return it in the pre-addressed envelope.

I assure you that the confidential nature of all information given will be respected and will not be disclosed to a third party.

Your valuable contribution to this study will be greatly appreciated.

Yours faithfully,

Recep KARABULUT

UNIVERSITY OF BRADFORD WEST YORKSHIRE BD7 1DP UK

TEL 01274 384239 TELEX 51309 UNIBFD G FAX 01274 391333

APPENDIX E

List of leasing companies in Turkey

APPENDIX E

LIST OF LEASING COMPANIES IN TURKEY

Leasing Companies	Capital (Million TL)
A. Financial Leasing Companies	
1. Iktisat Finansal Kiralama A.S.	58,058
2. Yapi ve Kredi Finansal Kiralama A.S.	110,000
3. Mengerler Finansal Kiralama A.S.	75,000
4. Is Genel Finansal Kiralama A.S.	35,000
5. Volkan Finansal Kiralama A.S.	2,000
6. BNP AK Dresdner Finansal Kiralama A.S.	120,000
7. Vakif Finansal Kiralama A.S.	65,000
8. Interlease Finansal Kiralama A.S.	10,000
9. TYT Finansal Kiralama A.S.	10,000
10. Gökçe Finansal Kiralama A.S.	4,000
11. Garanti Finansal Kiralama A.S.	40,000
12. Finans Finansal Kiralama A.S.	140,000
13. Halk Finansal Kiralama A.S.	150,00
14. Ziraat Finansal Kiralama A.S.	13,750
15. Demir Finansal Kiralama A.S.	15,000
16. Sistem Finansal Kiralama A.S.	5,000
17. Setat Finansal Kiralama A.S.	50,000
18. Evrensel Finansal Kiralama A.S.	5,000
19. Rant Finansal Kiralama A.S.	20,000
20. Es Finansal Kiralama A.S.	50,000
21. Ege Finansal Kiralama A.S.	15,000
22. Atlas Finansal Kiralama A.S.	15,000
23. Vakif Deniz Finansal Kiralama A.S.	15,000
24. Ticaret Finansal Kiralama A.S.	15,000
25. Marmara Finansal Kiralama A.S.	15,000
26. Citilease Finansal Kiralama A.S.	18,000

B. Development and Investment Banks

27.	Türkiye. Sinai Kalkinma Bankasi A.S.	300,000
28.	Türkiye. Kalkinma Bankasi A.S.	2,500,000
29.	Türk Merchant Bank A.S.	20,000
30.	Tekfen Yatirim ve Finansman Bankasi A.S.	60,000
31.	Birlesik Yatirm Bankasi A.S.	50,000
32.	Yatirm Bankasi A.S.	20,000
33.	Tat Yatirm Bankasi A.S.	50,000
34.	Park Yatirm Bankasi A.S.	100,000
35.	Avrupa Türk Yatirm Bankasi A.S.	20,000

C. Private Financial Institutions

36.	Al-Baraka Türk Özel Finans Kurumu A.S.	50,000
37.	Faisal Finans Kurumu A.S.	76,000
38.	Kuveyt Türk Evkaf Özel Finans Kurumu A.S.	130,000
39.	Anadolu Finans Kurumu A.S.	75,000

Source: UTFT General Directorate of Banking and Exchange, September 1993, p.84.

APPENDIX F

Monthly average exchange rates of Turkish Lira

APPENDIX F

MONTHLY AVERAGE EXCHANGE RATES OF TURKISH LIRA

Year	US $	DM	£	¥
1985	518.34	179.27	677.50	2.21
1986	669.39	310.64	982.24	4.01
1987	855.69	477.85	1,408.38	5.96
1988	1,420.76	809.87	2,527.81	11.11
1989	2,120.78	1,129.98	3,467.34	15.37
1990	2,607.62	1,620.64	4,669.75	18.15
1991	4,169.85	2,511.49	7,343.54	31.10
1992	6,887.51	4,422.34	12,083.95	54.41
1993	10,985.96	6,635.80	16,508.50	99.77
1994				
January	15,196.10	8,726.89	22,681.74	136.56
February	17,724.60	10,213.97	26,250.13	166.63
March	20,584.43	12,165.29	30,725.13	195.85
April	31,786.82	18,708.92	47,090.38	306.99
May	33,629.54	20,226.58	50,561.99	324.83

Source: Turkey, SPO Main Economic Indicators, May 1994.

APPENDIX G

Lease agreement statement form to UTFT

APPENDIX G

LEASE AGREEMENT STATEMENT FORM TO UTFT

Name of Lessee	:..
Name of Lessor	:..
Type of Leased Asset	:..
Period of Lease Contract	:..
Commencement of Lease Contract	:..
Value of Lease Contract	:..
• Total	:..
• Annual	:..
Mediator Bank	:..
Guarantor	:..
Type of Business Asset used	:..
Characteristics of Leased Asset	:..
• Invoice Value	:..
• Age	:..
• Depreciation Rate	:..