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The lease financing in Bangladesh: a satisfied progress in business and industrialization

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Abstract: This paper discusses the aspects of lease financing in Bangladesh. Bangladesh is a small but densely populated country in the South Asia and the people of it mainly depend on agricultural. Due to globalization and liberalization the country gradually shifting towards industrialization and lease becomes a pioneering and alternative way to develop the country through business and industrialization. Lease financing is the most important issue which determines the direction of financial behavior in an organization, a financial level of effort, and the organization's level of perseverance in the face of obstacles of other types of financing. To develop leasing business in Bangladesh it is needed for its convenience and flexibility in financing. An attempt has been taken here to explore the lease financing of Bangladesh in some details.

Keywords: Lease financing, Lessor and lessee, Microfinance, Capital market.

INTRODUCTION

Bangladesh is a small country densely populated country in the South Asia. The people of it mainly depend on agricultural. So that land is the main asset of this country. Due to globalization and liberalization the country gradually shifting towards industrialization. Financial globalization does not always work to encourage economic development because it often leads to devastating financial crises which are a great problem like the developing country Bangladesh. Recently the people of this country are taking risk and are establishing business enterprises. But these entrepreneurs are faced with various problems such as, scarcity of initial capital and shortage of working capital. The businessmen and industrialists need loan for long term and they try to direct financing from commercial banks, specialized banks and other financial institutions. Receiving long term loans from direct financing institutions in Bangladesh is very difficult. Lease financing is the most important issue which determines the direction of financial behavior in an organization, a financial level of effort, and the organization's level of perseverance in the face of obstacles of other types of financing. Leasing was able to confirm itself in many developed countries as one of the most effective and available mechanisms for financing the expansion and development of the means of production, asset finance necessary for the development and for the application of new technologies in business. Recently some leasing companies of Bangladesh are providing loan to the businessmen and industrialists. They provide loan with some conditions such as, length of lease term, interest rates, renewal and purchase options, cancellation provision and penalties, guarantees by lessee of residual values, amount and timing of lease payment etc.

Leasing is a contract between the owner of the asset which is called lessor and the business that wants to lease the equipment is called lessee or client. The broader definition of the of leasing is a trade and financing method by location by financial institutions specializing in these operations, by financial institutions or directly by manufacturers, to companies that carry out particular operations, or do not have sufficient borrowed or own funds to buy them. The harmonization of the legal framework for international leasing was accomplished on the 28 May 1988, by the adoption of the convention on international financial leasing by the Commission of the International

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Institute for Uniformity of Private Law (UNIDROIT), at Ottawa, which 59 countries participated and signed (Simon n.d.).

Financial globalization is primarily confined to rich countries that are from rich to other rich countries rather than, from rich to poor countries. Most international capital flows are just exchanges of assets between rich countries and are not flowing to poor countries to enhance their development (Obstfeld and Taylor 2004). But in recent years there is a huge increase in international capital flows. Lucas (1990) has pointed out that labor is incredibly cheap in poor countries, and so that capital would be very productive there. In a poor country wages are one-tenth those of in the USA, so that running a factory might be profitable there. Capital should have extremely high returns in poor countries and we would then expect massive flows of capital from rich countries where the returns on capital should be far lower to poor countries where it is higher. Laura et al. (2004) indicates that as we will see the main reason why capital does not flow from rich to poor countries is because of the weaker institutional environment in poor countries. The financial leasing is an effective investment in fixed funds of the enterprises; depend not only on the existence of laws, but also on the accuracy of leasing operations, effective risk management and a favorable investment climate.

The USA has the largest leasing industry in the world and lease financing contributes approximately one-third of total business investments. The USA is currently running enormous trade and current account deficits of over \$600B (billion) because Americans are buying more goods and services from abroad than they are selling overseas. These deficits are being financed by loans from foreigners, with emerging market countries providing on the order of \$200B per year. The Chinese government has accumulated almost \$800B of foreign assets, and is now one of the largest holders of the US Treasury Securities in the world. Mohajan (2012) has discussed the comparison between lease and purchase of a machine of a competitive firm with detail mathematical calculations.

THE FINANCIAL SECTOR IN BANGLADESH

The financial sector plays an important role in the development of Bangladesh. The contributions of improvement are as follows (Ahsan et al. 2006, Microfinance Industry Report 2009, Azim et al. 2011):

Money Market

The financial system in Bangladesh includes ‘Bangladesh Bank’ (the Central Bank of Bangladesh), scheduled banks, non-bank financial institutions (NBFIs), microfinance institutions (MFIs), insurance companies, co-operative banks, credit rating agencies and the stock exchanges. Among scheduled banks there are 4 nationalized commercial banks (NCBs), 5 state owned specialized banks (SBs), 30 domestic private commercial banks (PCBs), 9 foreign commercial banks (FCBs) and 28 non-bank financial institutions (NBFIs) as on 30 November 2006. Bangladesh Bank supervises and regulates all scheduled banks and non-bank financial institutions operating in Bangladesh. It maintains the traditional central banking roles of note issuance and the banker to the government and banks. It has the legal authority to impose penalties for non-compliance and also to interfere in the management of a bank if serious problems happen. NBFIs are the most important part of financial system in Bangladesh and their operations are regulated under the Financial Institutions Act 1993. The NBFIs consists of investment, finance, leasing

companies etc. There are 29 financial institutions operating in Bangladesh as of 30 November 2006. Of these one is government owned, 15 are local (private) and the other 13 are established under joint venture with foreign participation. Among the 29 financial institutions, 12 have been listed in the capital market up to 30 November 2006 to strengthen financial capability and the rest are under process to be listed in the capital market. The other financial institutions are House Building Finance Corporation (HBFC), Ansar-VDP Unnayan Bank and Karma Shangsthan which are all state owned ([Ahsan et al. 2006](#), [Microfinance Industry Report 2009](#), [Azim et al. 2011](#)).

Capital Market

The capital market in Bangladesh is yet to play its potential role as vehicle for financing long term investment. In Bangladesh it is regulated and supervised by the Securities and Exchange Commission (SEC) under the SEC Act, 1993. The SEC has issued licenses to 27 non-bank institutions to participate in the capital market of which 19 institutions are Merchant Bankers and Portfolio Managers, 7 are Issue Managers and 1 institution acts as Issue Manager and Underwriter. The Dhaka Stock Exchange (DSE) was established as a public limited company in April 1954, and the Chittagong Stock Exchange (CSE) was established in April 1995 to deal with the secondary capital market. At the end of 2008 the total number of enlisted securities with DSE stood at 328, of which 273 are listed companies, 14 mutual funds, 8 debentures and 44 treasury bonds. The Investment Corporation of Bangladesh (ICB) was established in 1976 and monitors the capital market which objective is to encourage and broaden the base of industrial investment. ICB also operates in both DSE and CSE as a dealer. There are some scheduled banks, such as Bangladesh Shilpa Bank (BSB), Bangladesh Shilpa Rin Sangstha (BSRS), Bangladesh Small Industries and Commerce (BASIS) Bank Limited, National Commercial Bank and some foreign banks are engaged in long-term industrial financing ([Ahsan et al. 2006](#), [Microfinance Industry Report 2009](#), [Azim et al. 2011](#)).

Insurance

The insurance sector is regulated by the Insurance Act, 1938 with regulatory oversight provided by the Controller of Insurance with authority granted by the Ministry of Commerce. A total of 68 insurance companies operate in Bangladesh, of which 21 provide life insurance and 47 are in the general insurance field. Among these life insurance companies, except for the state-owned Jiban Bima Corporation (GBC), a foreign owned American Life Insurance Company (ALICO), and the rest are privately owned. Regarding the general insurance companies, state-owned Shadharan Bima Corporation (SBC) is the most active in the insurance sector. A total of 44 insurance companies are listed in the capital market, of which 9 are life insurance. Delta Life Insurance is the market leader among the private sector insurance companies ([Ahsan et al. 2006](#), [Microfinance Industry Report 2009](#), [Azim et al. 2011](#)).

Microfinance Institutions

Microfinance Institutions (MFI) in Bangladesh have been unregulated since their inception. The government, with the close cooperation of Bangladesh Bank, established a regulatory framework which terminated in the enactment of the Micro-credit Regulatory Authority Act, 2006. The Act is containing 52 articles and 98 sub-articles. An Executive

Board consisting of eight members is responsible for executing the management's general and administrative tasks. The Board consists of the Governor of Bangladesh Bank as ex-officio chairperson, six government officials nominated by the government and one executive vice-president, who serve as the board's member secretary. The authority's main responsibilities include issuance and cancellation of licenses for micro-credit, and overseeing, supervising and facilitating all MFI activities. Grameen Bank was established in 1983 under a special law with the initial support from the Bangladesh Bank. The typically landless borrowers of Grameen Bank are mostly women, who are owners of the bank. In recognition of the robust poverty eradication program through microfinance activities, the Grameen Bank and its founder, Dr. Muhammad Yunus, were awarded the 2006 Nobel Peace Prize. It has now been globally recognized that microfinance can be easily implemented and has been replicated in many regions of the world as an effective anti-poverty tool. The member-owned Microfinance Institutions (MFIs) have an explicit social agenda to help poorer sections of the population, and particularly focus on rural women as clients. There are also more than 1,000 semi-formal institutions operating mostly in the rural sector of the country of these, BRAC, ASA, and PROSHIKA are considered the three largest NGO-MFIs. BRAC, one of the largest MFIs in Bangladesh, has taken recourse to structured finance by securitizing its micro-credit operation recently. This revolutionary innovation is for the first time in Bangladesh. It is anticipated that if the process of micro-credit securitization can go well and unhindered it will open up the opportunity for MFIs to diversify source of fund, reduce on-balance assets and have abundant fund for disbursement ([Ahsan et al. 2006](#), [Microfinance Industry Report 2009](#), [Azim et al. 2011](#)).

Cooperative Banks

In Bangladesh 119 cooperative banks are operating, of which 64 are central cooperative banks, 48 are land mortgage and rest 7 are other cooperative banks. The maximum share of total assets (90%) occupied by central cooperatives. Similarly maximum share deposits (85%) and advances (90%) are handled by central cooperatives ([Ahsan et al. 2006](#)).

THE BASIC PRINCIPLES OF A LEASE AGREEMENT

Leasing is a contract between the owner of the asset which is called lessor and the business that wants to lease the equipment is called lessee/client. Hence lease is a contract between the owner and the user of assets for a certain time period during which the second party uses an asset in exchange of making periodic rental payments to the first party without purchasing it. In up-fronted lease more rental are charged in the initial period and less in the later years of the contract and the opposite happens in back-ended leases. Under lease financing, the lessee regularly pays the fixed lease rent over a period of time at the beginning or at the end of 1 month, 3 months, 6 months or 1 year and at the end of the lease contract the asset reverts to the real owner. Leasing is a standard way of financing through which the payment being spread over the period of the lease and the installments paid being deductible according to the type of leasing contract. The client agrees to make payments to the leasing company over the life of the agreement and can purchase the equipment, return it to the lessor, or negotiate a lease extension, when the original agreement expires. Most lease contracts run from 3 to 7 years; however,

irrigation and other agricultural equipment leases often run a bit longer, to about 10 years. In the long-term lease contract the lessee is generally given an option to buy or renew the lease. Lease financing is an asset management based business that requires specialized expertise. It is more profitable in some special sectors where other financing will be less profitable than lease financing. Recently lease financing is the most emphasized topic to any challenging institution or organization to develop their financial resources as well as profit maximization or maximization of owner's equity. All types of assets such as land, buildings, plant and machinery equipment and transports are related to lease. The three major types of leases are the operating lease, financial/capital lease and the direct financing lease. By lease financing an organization can reach its specific destination. If an organization has effective lease financing efficiency it can survive and develop quickly than others. Leasing contracts usually include the following terms:

- Although the lessor is the legal owner of a leased asset, the lessee bears the risk and enjoys the returns. The lessee benefits if the assets operates ownership and use as two economic activities, and facilitates asset use without ownership (Miller and Upton 1976).
- The leasing company remains the equipment owner. The client acquires the right of temporary possession and use.
- The client must pay one or more lease payments when the lease is signed and the client obtains possession of the equipment; subsequent payments are usually made at periodic intervals.
- The leasing company may or may not recognize a salvage value in calculating leasing payments.
- Often the lease cannot be canceled, and if canceled, a substantial penalty may be imposed.
- Typically, the client is responsible for property taxes, insurance, and repairs not covered by the warranty.
- When the lease period ends, the client has the option to purchase the equipment, renew the lease, or return the equipment to the lessor.

Sometimes the lease contract is divided into primary and secondary lease for the purpose of lease rentals. Primary lease provides for the recovery of the cost of the asset and profit through lease rentals during a period of about 4 to 5 years. A perpetual secondary lease may follow it on nominal rentals. Leasing can cover anything from the hiring of a power tool for a day or the hiring a car for months to the hiring of a fleet of aircraft for decades or the hire of a building for centuries. Where assets are hired for longer periods they are usually referred to as being leased rather than hired but there is no clear distinction between the two terms.

A lessee can be individual or a firm interested in the use of an asset without owning. Lessors may be equipment manufacturer or leasing who bring together the manufacturer and users. In the USA equipment manufacturers and the largest group of lessors followed by bank.

CLASSIFICATION OF LEASES

A lease can be modified to the lessee's specific needs and structured in a number of ways. From the perspective of the lessor, there are three basic types of leases as follows:

Capital or Financial Lease

Long-term, non-cancelable lease contracts are known as financial leases. It combines some of the benefits of leasing with those of ownership. Hence a finance lease is structured as a non-cancelable agreement, where the leasing company buys the equipment which the client has chosen and the client uses the equipment for a significant period of its useful life. Financial leases also are called full-payout leases because payments during the lease term amortize the lessor's total purchase costs with a residual value of up to 5% of the original gaining price. Sometimes the present value of the minimum lease payment equals or exceeds 90% of the fair value of the leased property. Most financial leases are direct leases. The lessor buys the asset identified by the lessee from the manufacturer and signs a contract to lease it out to the lessee. Office building, multipurpose industrial building and even complete shopping centers are frequently financed with this method. Most lease backs are on a net-net basis, which means that the lessee pay all maintenance expense, property taxes, insurance and lease payment (Hamilton 1992, John 1964, Khanam 1995, Islam 1999, Bass and Henderson 2000). A financial lease agreement may provide for renewable of contract or purchase the asset by the lessee after the contract expires.

Operating Lease

An operational lease involves the lessee only renting an asset over a time period which is substantially less than the asset's economic life. In such cases operating lease may run for 3 to 5 years. The lease is usually responsible for maintenance and insurance. It is cancelable by the lessee prior to its expiration, the lessor provides service, maintenance and insurance, and the sum of all lease payments by the lessee does not necessary fully provide for the recovery of the asset cost. The leasing agency retains ownership of the equipment during the lease and recovers its capital costs through multiple rentals and the asset's final sale (Jones 1992, Islam 1999, Bass and Henderson 2000). In economic matter a finance lease is a loan of money with the asset as security. The economic ownership of the asset, the risks and rewards of ownership lies with the lessee. Hence the finance lessee buys the asset with a loan from the finance lessor. A finance lease may be viewed as an arrangement under which the lessor provides the money to buy an asset which is used by the lessee in return for an interest charge and the lessor has security because he owns the asset.

Sale Leaseback

The sale leaseback is a transaction in which the owner of the property sells the property to another which is simultaneously leases it back from the new owner. The use of the property is generally continued without disruption. The advantages of a sale lease back from the seller's perspective as follows: If the purchase of asset has already been financed then a sale leaseback can allow the seller to refinance at lower rates, if rates of asset have dropped and provide another source of working capital, if liquidity is tight. When a company purchases equipment then it may not realize that it was going to be a minimum tax and that ownership might increase its minimum tax liability. By selling the property, the seller lessee may deduct the entire lease payment that is may not be a minimum tax (Islam 1999). In 1989, Shipping Credit and Investment Corporation of

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India purchased Great Eastern Shipping Company's bulk carrier Jag Lata, for Rs.12.5 crore (1 crore = 10,000,000) and then leased it back to Great Eastern Shipping Company on a 5-year lease, the rental being Rs.28.13 lakh (1 lakh = 100,000) per month and the ship's written down book value was Rs.2.5 crore.

Hire-purchase Lease

A hire-purchase lease is an alternative to a lending transaction for the asset purchase and usually employed for retail or individual financing of smaller ticket items, such as motorcycles, sewing machines, refrigerators etc. The client assumes a higher down payment up to 30% of the purchase price, and with each lease payment retains a higher percentage of equipment ownership to build equity. In this type of purchase the asset price and risk involved in the financial transaction are spread over the lease term (Bass and Henderson 2000).

There are some other terminologies of lease as follows:

Leveraged Lease

Leveraged lease involves lessor, lessee and financier. Lessor provides equity equal to approximately 25% of the asset's cost while the remaining amount is provided by the financial institution, mainly as loan. Now it is a global popular method of financing for expensive assets.

Cross-border Lease

In the cross-border or international lease the lessor and lessee are situated in two different countries. The lease transaction takes place between companies or parties of two or more countries. It involves relationships and tax implications more complex than the domestic lease.

Direct Lease

Direct lease is a mix of operating and finance lease on a full payout basis and provides for the purchase option to the lessee.

Wet and Dry Lease

In the aircraft industry when the lease involves financing, servicing and providing fuel, then it is called wet lease. On the other hand if the lease is only related to financing then it is called dry lease.

Master Lease

Master lease provides finance longer than asset's economic life and holds the lessor responsible for providing equipment in good operating system during the lease period.

Closed and Open Ended Lease

In the closed ended lease the asset gets transferred to the lessor at the end the risk of obsolescence, residual value etc. remain with the lessor, as lessor being the legal owner of the asset. In the open ended lease the lessee has the option of purchasing the asset at the end of the lease.

LEASE FINANCING IN BANGLADESH

Leasing can be traced back 5,000 years to ancient Greece and the Middle East, where it was used in agricultural transactions. The mechanization of agriculture and the Industrial Age brought further specialization to leasing (Bass and Henderson 2000). Leasing was known in ancient Babylon in 2000 BC. Including leasing practice in economic relations took place in the year 1877, when telephone company 'Bell' decided not to sell the telephone appliances made by them, but to lease them. The lease of asset started in the USA and in Europe to business and industry development since World War II. After World War II, the victorious allies decided to create a new international system to promote world trade and prosperity, which resulted in the establishment of two new international financial institutions, the International Monetary Fund (IMF) and the World Bank, and also the General Agreement on Tariffs and Trade (GATT) whose successor organization was the World Trade Organization (WTO) (Mishkin 2005). At present thousands of businesses which are long on ideas and short on cash are using leasing as a simple and flexible financing solution to increase productivity and generate profits.

Bangladesh is a developing country; the national calamity and political unrest slow the industrial growth as well as economic growth of the country. In this country most of the people depend on agriculture only. Lease financing was first introduced in Bangladesh in the early 1980s. Industrial Development Leasing Company of Bangladesh Limited (IDLC), the first leasing company of the country, was established in 1986 under the regulatory framework of Bangladesh Bank. It was a joint venture of the Industrial Promotion and Development Company of Bangladesh Limited (IPDC), International Finance Corporation, and Korea Development Leasing Corporation. Another leasing firm, the United Leasing Company Limited started its operations in 1989. The number of leasing companies grew quickly after 1994 and by the year 2000, raised to 16. In terms of money value, the leasing business in Bangladesh increased from Tk.41.44M (million) (here Bangladeshi currency is Taka = Tk.) in 1988 to Tk.3.16B in 2000. The leasing companies now operating in the country are as follows: Industrial Development Leasing Company of Bangladesh, United Leasing Company, GSP Finance Company (Bangladesh), Uttara Finance and Investments, Bay Leasing and Investment, Phoenix Finance & Investments Limited (PFIL) (Former Phoenix Leasing Company Limited), Prime Finance and Investment, International Leasing and Financial Services, Union Capital, Vanik Bangladesh, Peoples Leasing and Financial Services, Bangladesh Industrial Finance Company, UAE-Bangladesh Investment Company, Bangladesh Finance and Investment Company, and First Lease International. The objectives of lease financing in Bangladesh being as follows:

- to assist the development and promotion of productive enterprises by providing equipment lease financing and related services,
- to assist in balancing, modernization, replacement and expansion of existing enterprises,
- to extend financial support to small and medium scale enterprises,
- to provide finance for various agriculture equipment, and
- to activate the capital market by operating as managers to the issue, underwriters, or portfolio managers.

The leasing business in Bangladesh involves in regular leasing activities and is now involved in stock-market related activities such as issue management, underwriting, trust management, private placement, portfolio management and mutual fund operations. The lease financing services are textiles, food and beverage, transport, apparels and accessories, paper and printing, pharmaceuticals, construction and engineering, chemicals, telecommunications, agro-based industries, and leather and leather products. Private leasing companies attract clients by providing relatively better services and the down payments of their leasing are not high and the growth period is low. In Bangladesh leasing companies face some problems in conducting their business. The relatively slow growth of the demand side compared to the fast growth of the lease business is one such problem. Leasing companies often find difficulties to raise funds through short- or long-term borrowing from money and capital markets. They are hard pressed to deal with the financial assets because of the present laws of the country, which are also not fully enforceable. The leasing market is becoming more competitive because of the new leasing companies are entering in the market. The political stability and overall economic development is an essential precondition of the smooth growth of this sector.

CONTRIBUTION OF LEASING COMPANIES IN BANGLADESH

There are mainly three leasing companies in Bangladesh which are as follows: The Industrial Development Leasing Company (IDLC) Limited, The United Leasing Company (ULC) Limited and Phoenix Finance & Investments Limited (PFIL). Recently some other leasing companies such as, Peoples Leasing Company, Industrial Leasing and Financial Services Limited, The Uttara Finance & Investment Company Limited, Bay Eastern Leasing Company, GSP Finance, Prime Finance & Investment Limited, Vonike and Prime Bank Limited have emerged in the financial market of Bangladesh.

Industrial Development Leasing Company Limited

Industrial Development Leasing Company Limited (IDLC) is the first and the largest leasing company of Bangladesh. IDLC of Bangladesh limited is established in 1985 as a joint venture public limited company with the multinational collaboration of International Development Finance Institution, Commercial Banks, Insurance Company and Foreign Leasing Corporation. In October 1990 it has established its first branch at Chittagong. Its primary focus has been in the area of 3-5 year term financial leasing with particular emphasis on balancing, modernization, replacement and expansion (BMRE) of existing units. It has been established with the multinational collaboration of Development Finance Institutions, Commercial banks, Insurance and leasing companies. After 10 years of its commencement, IDLC has captured almost 60% of the total market share of lease finance in the country. It was listed in Dhaka Stock Exchange (DSE) on the 20 March 1993 and on the 7 February 1994 it was duly licensed under the Bangladesh Bank. It finance very few to individuals but corporate financed through operating lease is the general nature of business. Generally, IDLC does not encourage new entrepreneurs or new line of business. Modernizing, replacing and expanding are the main objectives of leasing, when equipment is concerned for vehicle both new and reconditioned cars is taken into consideration. Its clientele is primarily corporate bodies. The ratio of corporate to individual clients is 95:5. It has experienced increasing growth of lease contracts from 1993 to 1997 and compound growth rate of lease contract was 29.31%. Operational

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revenue has increased from Tk.275.54M in 1993 to Tk.768.55M in 1997. It also started an additional and alternative source of capital asset financing in different enterprises in the private sector. Short-term finance has broadened its customer base and is expected to contribute significantly to its growth and profitability. At present lease financing has grown to be an industry of Tk.3.5B per annum.

United Leasing Company Limited

Subscription agreement of United Leasing Company Limited (ULC) was signed among the sponsors on 9 March 1989, incorporated on 27 April 1989 and investment agreement has signed by the company with Asian Development Bank (ADB) in Manila on 27 July 1989. The company signed the first lease agreement with the lessee on 12 September 1989. The ULC signed a loan agreement with CDC in London on 27 March 1992. The company has issued 75,000 shares on 28 March 1994. It has opened its first branch in Chittagong on 16 June 1994, Jessore Branch in 2005, Gazipur Branch in 2006, and Bogra Branch in 2006. It traded its shares on DSE for the first time in 23 June 1994. It has duly licensed under Financial Institutions Act, 1993 on 7 February 1995. It has declared first dividend on 20 April 1995. Its authorized capital is Tk.120M and issued, subscribed, and paid up capital is Tk.70M ([Annual Report 1992-1997](#)). ULC financed its portfolio largely through medium and short-term loans from local banks and long-term loans from the World Bank and KFW of Germany. Operational revenue has increased from Tk.97.57M in 1992 to Tk.523.40M in 1997. In 1992 operating income was Tk.15.63M and in 1997 it has become Tk.68.86M ([Islam 1999](#)).

Phoenix Finance and Investments Limited

Phoenix Finance & Investments Limited (PFIL) (Former Phoenix Leasing Company Limited), one of the leading and reliable multi products Financial Institution in Bangladesh has incorporated on 19 April 1995 and started business on the same date. It was duly licensed under Bangladesh Bank on 9 May 1995 as a non-banking financial institution under Financial Institution Act 1993. It signed the first lease agreement on the 21 September 1995. It opened its first branch in Chittagong on 25 September 1996. The company is being operated through its all offices located at Dhaka (main office), Chittagong, Khulna and Bogra districts in Bangladesh. The authorized capital of the company is Tk.500M and issued; subscribed and paid-up capital is Tk.50M ([Annual Report 1992-1997](#)). The Company has changed its name to Phoenix Finance and Investments Limited from Phoenix Leasing Company Limited with effect from first February 2007 complying with all the legal requirements in that respect.

Authorized capital of the Company is Tk.1B divided into 10,000,000 ordinary shares of TK.100 each. PFIL has floated its share through the Initial Public Offering (IPO) of the Company for 12,50,000 ordinary share of Tk.100 each for amounting to Tk.125M in 2007. Now the paid up capital of the company has been raised to 3,361,875 share amounting to Tk.336,187,500. The shares of the company were listed with DSE and CSE on 25 September 2007.

Sponsor shareholders of the company includes a renowned corporate body namely Phoenix Insurance Company Ltd., a leading insurance company in Bangladesh .Others are individuals having wide range of experience in the field of commerce and industries .

The main objective of PFIL is to allocate scarce financial resources to capital investment through funding in capital machinery/equipment specially balancing, modernization, replacement and expansion (BMRE) of the existing industrial enterprise to stimulate the industrial development of the country and also to provide financial assistance through leasing and other multi-dimensional products and services to all levels of entrepreneurs for a wider range of asset acquisition.

The company has also diversified its products and services to such other areas as housing and real estate, bridge financing, short-term and mid-term loan and startup working capital to cater to divergent needs of the economy. It also opened a Small and Medium Enterprise (SME) branch in Dhaka on 7 February 2007 for promoting SME exclusively for alleviation of poverty through creation of employment and generation of income on a sustainable basis. Besides this, PFIL also recently acquired 100% ownership of Brokerage Company dealing with the DSE to further diversify its investment activities.

The company extends lease finance for capital machinery, energy generating equipments, construction and medical equipments, office equipments, all kinds of road and marine transports, household and other essential items and equipments for business enterprises like mills, factories, financial institutions, banks and insurance companies as well as educational institutions, clinics, hospitals, corporate bodies and individuals. The company also extends term loan and house building loan facilities to established business enterprises, industrial units and individuals.

Bay Leasing and Investment Limited

Bay Leasing & Investment Limited (BLI) is a public limited company was incorporated in Bangladesh on 7 February 1996 under the Companies Act 1994 and Bangladesh Bank has granted license to the company on 25 May 1996 to function as a NBFIs under the Financial Institution Act 1993 and the Financial Institutional Regulation of 1994. It also registered itself as a Merchant Bank with the Securities & Exchange Commission on 25 June 1998. It extends lease financing as its core business for all types of machinery and equipment including vehicles for industrial, commercial and private purpose. It has also expanded its activities into term financing, housing finance and merchant banking operations. The authorized and paid up capital of the company stood as Tk.500M and Tk.102M respectively as on 31 December 2007 ([Bay Leasing and Investment Limited 2008](#)).

Bangladesh Finance and Investment Company Limited

Bangladesh Finance and Investment Company Limited (BFICL) is a non-banking finance company incorporated in Bangladesh on 10 May 1999 as a public limited company and it began business on 15 February 2000. Its authorized and paid up capital are Tk.500M and Tk.23M respectively, and the capital is divided into ordinary shares of Tk.100 each. The business objectives of the company are moving out direct trade, term and working capital financing, housing finance, equity participation, financial and industrial counseling, fund management, and merchant banking activities of all types.

Main sectors in which the company has targeted to lease and invest are transport, electric and electronic goods (including computers), leather, textile, printing, marine vehicles and equipment, steel and engineering, fishing boats and trawlers, medical equipment and small scale industries. It purchases property in its own name and pays

60% to 70% of the total price of a particular property to its supplier. It signs lease contracts with the lessee, generally for 2 to 4 years, and handed over the properties to him for use. Lease installments generally payable on a monthly basis and are determined on the basis of the lease price of properties and other relevant factors.

Uttara Finance and Investments Limited

Uttara Finance and Investments Limited (UFIL) is a joint venture leasing and financing company in Bangladesh. It is registered as a non banking financial institution under the Financial Institutions Act 1993 and the Companies Act 1994 with the license from Bangladesh Bank to operate and transact all kinds of businesses as provided under the relevant laws. It has been incorporated on 7 May 1995 but the company received license from Bangladesh Bank on 7 September 1995 and the company started commercial operation from 1 November 1995 and continuing with success. It mainly upholds its commitment towards the development of financial service sector by offering high quality services to the local entrepreneurs and focuses to the ever changing and challenging business environment. With its continuous drive to improve, it is well on track to be considered as one of the leading leasing company of the country.

FINANCIAL LEASING IN BUSINESS INVESTMENTS

Investment decisions are designed to identify and select the most profitable projects for the investment of money on the long-term, so that a company waives its internal flexibility and becomes more vulnerable. The company increases future cash flows, so that the investment decision implies the identification and proper planning of revenues expected during the life cycle of the investment project. Hence the investment process is an important component of strategic management. There are three financial flows that characterize the investment process as follows (Simon n.d.):

i) The cost of the investment is a net negative financial flow, consists of the expenses that the company purchase and installs the equipment, initial value of necessary intangible assets and the original value of the current assets. The cost of the investment of a company is given as follows:

$$C_I = V_{FA} + V_{IA} + V_{CA} + O_C - V_{LFA} , \quad (1)$$

where,

- C_I = the cost of the investment,
- V_{FA} = the value of fixed assets invested,
- V_{IA} = the value of intangible assets invested,
- V_{CA} = the initial value of current assets,
- O_C = other investment costs, and
- V_{LFA} = the liquidation value of fixed assets replaced.

The liquidation value of the fixed assets is given by;

$$V_{LFA} = \text{selling price} - (\text{selling price} - \text{stock value}) \times \text{tax rate on income.} \quad (2)$$

ii) In financial flows during the life of the investment project the profit is not a good indicator of the outcome of the economic activity, because it may vary depending on what methods are applied for the assessment of costs. Hence the evaluation of the

operational results of the investment is made based on the cash flow. The annual positive flows generated by the investment are as follows:

$$P_F = N_P + D + A_{IA} + I \pm \Delta W_C - O_F, \quad (3)$$

where,

P_F = the annual positive flows generated by the investment,

N_P = the net profit,

D = the annual depreciation of fixed assets,

A_{IA} = the annual amortization of intangible assets,

I = interest on loans and leasing used to finance the investment,

ΔW_C = the changes in the working capital, and

O_F = other financial flows.

iii) Financial flows related to the liquidation of the investment are given by:

$$L_F = V_{LFA} + W_C, \quad (4)$$

where,

L_F = liquidation flow,

V_{LFA} = the liquidation of fixed assets, and

W_C = working capital when the investment is liquidated.

DIFFERENCE BETWEEN LEASING AND LENDING

In an apparent view it seems that there is no difference between lease and lend. But leasing and lending are different financing activities and the difference between them is given as follows: With a lease, the leasing company gains asset ownership, takes depreciation benefits, and may pass the benefits along to the client through lower rental payments. The business has the option to purchase or re-lease the asset at the fair market value at the lease's end. The leased equipment is usually all that is needed to secure a lease transaction. A lease requires a small or no down payment and finances only the equipment's value. The value is expected to be depleted over the lease term. The client usually has an option to buy the equipment for its remaining value at the end of lease.

On the other hand in lending a loan requires the borrower to pledge assets for collateral. The end user bears all risk of equipment devaluation. Upon signing for a loan, the end user must pay a down payment. The loan finances the remaining amount.

Leasing terms may be longer than loan terms because leasing is tailored to the life of the asset and a business' cash flow. Total expenses in lease are higher than a loan and lease arrangements are usually more liberal than loans. The risks for finance leases are not significantly larger than that for loans because residual value risk is rarely involved and the liability and litigation risk is offset by the lesser portfolio risk.

ADVANTAGES AND DRAWBACKS OF LEASING

The World Bank's private sector firm, asset-based financing and leasing are particularly attractive to small and medium-sized businesses. Because the leasing company keeps legal ownership of the leased asset over the lease term, and a lessee can qualify for the leased equipment based on generated cash flow rather than credit history,

assets, or capital base. The leasing has some disadvantages also. Some of the advantages of leasing are as follows (Amembal 2000, Carter 1996, Nair 2004):

- In most developing countries, leasing may be the only form of medium- to long-term financing available to purchase of equipment that can expand production levels or increase productivity of workers. It also micro finance for fixed assets which provides MFIs with an opportunity to reach new borrowers and expand existing markets. Leasing is perhaps the most important advantage in developing countries, where unclear property rights, poorly functioning asset registries, and weak laws of secured transaction constrain lending. In case of default, legal ownership of the equipment allows a lessor to repossess equipment more easily than it is for a lender to take possession of collateral in case of loan repayment defaults. The nature of asset ownership in a lease transaction also has an advantage if the lessee declares bankruptcy then lease payments have priority over loan payments and typically, the lessee is allowed to continue making lease payments.
- Growth of leasing sector requires that leasing companies have access to capital market which leads to increased borrowing from banks as well as from the capital market, thereby increasing the gross capital base of a country. Leasing companies raise capital from pension funds and insurance companies, innovative bond offerings, securitizing of their lease receivables, and listing in the equity market. All these activities contribute to capital market development.
- Lessors are often willing to lease to entities that cannot access bank credit. Legal ownership of leased assets allows the lessor to require lesser equity than demanded by lenders and less or no additional collateral. SMEs benefit most from leasing. Finance for SMEs has been called the ‘missing middle’ of finance since banks mostly address the needs of large enterprises and microfinance organizations (MFOs) are increasingly addressing the needs of micro-enterprises (World Bank Group and IFC 2003).
- As an additional source of investment financing, leasing competes with bank financing. This provides incentive for both banks and lessors to become more efficient and innovative, leading to better products, and lower spreads in interest rates. Well-developed leasing markets in the USA and Western Europe suggest that leasing can play an important role in overall economic growth. Leasing is also an effective mechanism to help businesses without credit history and collateral needs to finance investments in equipment. In several developing and transition economies, the leasing sector has contributed significantly to deepening financial markets and overcoming legal and regulatory problems particularly relating to property rights and secured interest in collateral. IFC considers leasing as a high impact development activity in deepening financial markets and supporting SMEs (IFC 2003).
- Leasing provides efficient and effective use of available capital, since the leasing company purchases the equipment directly from the supplier, the lessee cannot use borrowed funds for other purposes. Leasing can be arranged more quickly and simply than conventional bank loans because additional security often does not need to be established. The costs of assigning additional collateral, documentation and processing times for bank loans can be significant

and usually offset the higher spreads in leasing. Some cases leasing creates an opportunity for lower equipment prices because of higher sales volume.

- A lessee avoids many of the restrictive agreements which are normally included in long-term loan agreements while borrowing from financial institutions or commercial banks. Besides, the leasing does not warrant any mortgage of the asset since it belongs to the lessor. In the case of leasing, the asset is made available to the lessee for immediate use without loss of time in applying for loan, waiting for its approval, buying asset subsequently etc. and lease rental payments may also be matched with the cash flows availability of the lessee. A satisfactory understanding of rights and obligations under a lease contract can serve to minimize or eliminate adverse decrease in service or resale value of leased equipment arising from deficient maintenance activities. A lease contract will have to incorporate periodic inspections of the leased equipment to confirm adherence to a maintenance program and assessment of equipment value.
- Simpler security arrangements, in combination with less stringent requirements for historical balance sheets mean that new small and micro-enterprises can access lease finance more easily than bank loans.
- The up-front cash down-payment or security deposit required in a lease contract is lower than the equity component in conventional bank financing. Leasing can finance a higher percentage of the capital cost of equipment thereby allowing the business entity to preserve its cash resources or existing bank facilities to meet working capital needs. Leasing contracts can more easily be structured to match the cash flow generation of the lessee's business. In some cases, the down payment required may be less than the typical 10%.
- In a typical tax-treatment of leasing, lessors benefit from being able to take capital allowances on the leased equipment. Tax incentives are available through lease financing. Lessees can equalize their full lease payments against income before tax, compared to the depreciation allowance or the interest charges on bank loans. The lessors may be able to pass on to lessees some tax benefits related to the depreciation charges they can book as owners of the asset leased, by lowering their financing costs or reducing their spread between funding cost vis-à-vis lease discount factor.
- The leasing company keeps ownership of the leased asset, which is generally used as collateral for the transaction, contributing toward simpler legal security arrangements and providing a tax deduction for asset depreciation.
- Lease transactions can be arranged quickly and simply. As a result, the lessor can more accurately project cash flow during the equipment lease term, assuming that the client meets lease payments. Knowing the cash flow associated with the lease facilitates planning and mitigates risk. Lenient requirements mean that clients can more easily access financing.
- Leasing typically offers medium- to long-term financing at a fixed rate over the term of the lease. The leasing company can then easily quantify the margins between funding and transaction costs on the lease contract.
- Transaction costs of contracting a lease is likely to be lower than that of executing a loan contract since the cost of creating, perfecting, and enforcing security for loans is avoided. In most developing countries, asset registries are

not computerized and are fragmented geographically or by type of asset. This makes security perfection a long and costly process. Similarly, enforcing security is typically an unwieldy process and costly process. In contrast, repossession of leased equipment is usually faster and cheaper.

The disadvantages of leasing are as follows (Bass and Henderson 2000):

- Asset ownership remains with the lessor, which sustains the cost related depreciation. In most cases, the lease term is usually shorter than the asset's useful life. MFIs should consider the asset's life span and potential for resale because these influence the terms and costs of the lease.
- Many costs are fixed and independent of the characteristics of the leasing company, client, or asset. Hence for leases on lower priced assets, transaction costs will be a more significant payment component.
- The revenue generated through leasing must exceed the lessor's cost of funds to be profitable. An MFI's cost of funds tends to be higher than present market rates. Given the nature of leasing and its substantial up-front capital costs, this can have a negative impact on the MFI's liquidity and decreases its profitability.
- A major difference between leasing and lending is the residual value of leasing; this is the book value that the leasing company uses to depreciate an asset during the lease term. This is the wild card of leasing because huge profits or losses are occasioned on realization of the salvage value. Measurement of the future value of assets includes both the potential gain and possible loss and is extremely important to the profitability of leasing.

GLOBAL LEASING MARKET AND DEVELOPMENT IMPACT

The global leasing market was worth \$476.6B in 2001 (World Leasing Yearbook 2003). Only Europe and North America account for 82.7% of this market volume. Modern leasing emerged in the 1950s as a specialized financial service industry in the USA. The industry expanded to Europe and Japan in the 1960s and to the developing countries in the 1970s. Table-1 gives the leasing volumes in selected countries of the world. Leasing is used in all economic sectors and for all asset types.

Table 1: Annual leasing volumes in selected countries, 2001. Source: World Leasing Yearbook 2003.

Country	Annual Leasing Volume (\$ billion)
U.S.A.	242.00
Japan	58.95
Germany	34.45
Brazil	3.52
China	2.10
Russia	1.90
South Korea	1.17
India	1.05
Mexico	0.90
Columbia	0.76
Turkey	0.72
Pakistan	0.37

Mohajan, H.K. (2012), The Lease Financing in Bangladesh: A Satisfied Progress in Business and Industrialization, *International Journal of Finance and Policy Analysis*, 4(1): 9–24.

In the USA 10.2% of the leasing volume is in agriculture ([World Leasing Yearbook 2003](#)). Usually the significance of leasing in a country is estimated by market penetration.

CONCLUDING REMARKS

In this paper we have discussed aspects of financial leasing in Bangladesh in some details. Leasing business in Bangladesh has been developed within a very short period of time and its further development is increasing continuously. The popularity of lease financing in Bangladesh is due to tax advantages, timesaving and conservation of cash and funds provide by the lessors. At the first sight the lease finance seems to be simple but it is not so and a correct decision requires an assessment of almost all the surfaces of financial decision making. The leasing companies should establish their own systems of risk assessment and control to avoid their occurrence or, when risks do appear, to have good methods and techniques of risk management. The government and entrepreneurs of Bangladesh must be active to develop the lease financing for the economic development of the country. We have investigated some financial leasing companies who are operating in Bangladesh. The difference between lease and lend is given briefly but the advantages and drawbacks of leasing are given elaborately. Finally we have highlighted global leasing market to compare the leasing of Bangladesh with developed countries.

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