Leasing: The Story of an Industry

By Brandon Morris

The year 1977 will go down in history as an eventful year to all Sri Lankans. It was in this year that the government in power introduced liberalized economic policies to Sri Lanka, thus paving the way for free enterprise. With this move a large number of opportunities sprung up for a multitude of businesses of varying scales. However, not many of the old established firms in the commercial sector were sufficiently flexible or innovative to make use of the available opportunities. The few who were, had no difficulty in obtaining their funding from traditional sources, the development financial institutions and banks.

Apart from these large firms, there were also a large number of small enterprises and innovative individuals anxious, with new ideas, to grab these opportunities. Nevertheless, they did not have the necessary financial resources. These entrepreneurs were not acceptable to the conventional risk averse lenders who found their lack of proper accounting information and previous business history adequate grounds to reject their applications. On the other hand, large firms with established financial records and having influence to the bureaucrats, found no difficulty in approaching the lending institutions for their capital requirements. However, the government-wasted no time in identifying this critical issue that was hampering the growth of the country and quickly enlisted the support of the World Bank for assistance.

In 1980, the World Bank, which conducted a survey of the capital market in the country, at the request of the Government of Sri Lanka, made recommendations intended to increase the level of capital formation in the country. One of their recommendations was that steps should be taken to promote the setting up of a leasing industry in Sri Lanka. Consequently, a joint venture project was set up in March 1980.

At first a reluctance to accept the concept of leasing was apparent amongst the large companies. Conversely, there was a lot of enthusiasm forthcoming from the small and medium scale business enterprises. However, with the passage of time, the large companies too found leasing to be the convenient and flexible form of financing it claimed to be. Soon, leasing became a common form of financing

resorted to by every type of business. New leasing companies were started and even conventional lenders recognizing the value of leasing, either offered leasing as part of their services or set up subsidiary companies to engage in leasing.

Unlike in the case of the global leasing market, in Sri Lanka, the majority of the leases are for motor vehicles. It is not surprising that this figure is as high as 80% or even more, of the total leasing market. This is mainly not due to the fact that there is no demand for equipment leasing but merely due to the reluctance of the part of lessors to promote equipment leases. The reasons for this reluctance are quite simple. A motor vehicle is a moveable asset and hence, repossession in the event of default does not pose great difficulty. On the other hand, equipment is often placed inside the factory or business premises of lessees and poses tremendous hardship to the lessor in the event of repossession for non-payment of lease rentals. Apart from this, the prevalent capital allowances for leasing of equipment have discouraged many lessors from engaging in it.

Today customers the world over, are more sophisticated and familiar with leasing as a method of finance. Increasingly, customers do not want to wait for lawyers, documentation, or other time-consuming aspects of the origination process. In fact, customers will occasionally challenge traditional ways of doing business. As a result, lessors and vendors are faced with the task of closing a transaction quickly, before the customer takes his or her business elsewhere. Equally as important, customers are more sophisticated and familiar with equipment leasing as a method of finance. This has increased customer scrutiny of transaction terms, conditions, speed of delivery and most importantly pricing.

Pricing is the number one concern for customers and lessors believe that its importance is increasing every year. Customers' use pricing as a filter, meaning that lessors have to be in a certain price range to even be considered for their business. However, if a lessor makes it past the initial price filter, then there is always the possibility of an established relationship leading to a pricing premium. Lessees increasingly are taking tougher stands when negotiating with lessors as their knowledge level of leasing increases. In addition, lessees are exercising more care in their selection of a lessor.

A close scrutiny of the leasing customer would also reveal that the loyalty element tends to decline at an increasing pace. The reason for this alarming trend is believed to be the commoditization of leasing. It is believed that lessees are increasingly playing lessors off against each other in order to obtain the most competitive

price and service. The reluctance of lessors to share information with regard to the in tegrity of lessees and not being able to adapt to minimum price ceiling has resulted in this problem being further aggravated.

Funding problems is another growing issue that has hampered the growth of the leasing industry in Sri Lanka. Specialized leasing companies are prevented from soliciting deposits directly from the public without a banking license or being registered as a finance company. This has resulted in these companies having to seek the assistance from their very own competitors (i.e. commercial banks and development fund institutions) for funding requirements. This non-level playing field has resulted in banks having access to low cost funds while other lessors do not have this advantage.

In general, what can be said for the local leasing industry is that it is closely following the international trends consciously or unconsciously, in most aspects. However, in terms of technology and the Internet, the local industry is far behind the international industry. There is hardly any evidence of leasing through the Internet. Although some companies maintain web sites, the response from customers with regard to making applications for leases through the Internet has been extremely poor.

The sluggish growth in the Sri Lankan economy has resulted in lessees trying their best at every given opportunity to lower their cost, thereby considering interest rate as their prime deciding factor when choosing lessors. Despite lessors trying numer-ous ways to differentiate their product from competitors by augmenting it, interest rate is still paramount in the minds of the lessees.

However, as leasing becomes more sophisticated, particularly in the large ticket segment, it is envisaged that creativity will also become more important to the customer than pricing. It is in this context that the leasing business model will have to move towards offering more services to customers and away from simply off Pring competitive pricing. Furthermore, lessors will have to truly practice market orientation rather than limiting it to a mere “lip service” and focus more on managing their brand effectively, as a means of dealing with the competition.