

The Leasing – Evolutions and Trends

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Abstract

In any society, businesses have always needed to use limited material and financial resources, unfortunately limited, in their economic activities. The leasing became an alternative to the classical form of lending.

Due to the rapid technical progress, the product renewal and obsolescence of equipment and working facilities are particularly accelerated, and the leasing proves to be a cost-effective and easy way to extend and upgrade tools, machines and production.

Throughout the history, the lease became more important due to the rapid development of technology in agriculture, industry and transport. In Romania, after 1989, the lease has a rapid growth between 1996-2008, the rise amid to the development of companies based on Government's regulations, in 2008 the leasing financing 4% of Romanian GDP.

The Romanian leasing market is analyzed in this paper, starting from the official statistics for 2007-2012, processed and interpreted by the author.

The analysis revealed the fact that on the background of the economic crisis, the leasing market decreased dramatically, a major consequence being the decrease of the lease's share in GDP, at 1 % of GDP in June 2012, in the same time with the economic activity's decrease and decrease in purchasing power. The leasing market registered a 75 % decrease in the analyzed period, from 4948 mil.Euro in 2007 to 1243 mil. Euro in December 2013. Contrary to the market trend, we can say that the lease remains the main way of acquisition, especially for equipment and new vehicles, whose share market was 84-85% of the lease market year in the last 3 years.

The paper presents also the legal basis of the lease, the main types of leases used in the Romanian market, especially for SMEs, and the advantages and disadvantages of this type of financing.

Keywords: *operational and financial leasing, economic crisis, financing, the leasing market*

JEL Classification: *D53, G23, H89*

Introduction

The first evidence of lease or rent dates to about 2000 BC, being discovered in 1984 the first rental agreement in the ancient Sumerian city of Ur. Other proofs of lease are Murashu family documents (400-450 BC), known as the leader in the market of rental services in the Persian Empire, the rental of war ships and weapons (the attack of England in 1066 A.D. by the Norwegians and Normands), the rental of horses in the Middle Ages, as well as equipment and facilities for agricultural industry.

The nineteenth century was marked by a significant increase in leasing activity, due to the increasing diversity of rented tools. The development of technology in agriculture, manufacturing and transport made leasing more important.

In the twentieth century lease has become even more important. In the first decades of the century producers realized that it was very difficult to find the funds to buy new equipment in the same time, so the lease was defined in that period as a way of possessing both the property and the technology. For example, Bell's telephone company gives its appliances only on lease.

Leasing has become a part of daily life in the United States and Western Europe in the car's industry.

Leasing date of birth is considered to be 1954, when the accelerated depreciation of leased property was used for tax purposes, leading to a low cost of the lease.

After 1989, following the lessons from the history of consumer credit and leasing, the emerging market of Romania started to use products like leasing and consumer credit in an increasing market, regulated by the credit law and the leasing law, becoming usually financial tools for Romanian investors.

The lease term comes from the English word "lease" which means "to rent". The English term has its roots in the old French word "lesser laisser" ("leaving") extracted from Latin word "laxus" ("free", "light").

In the U.S.A, the lease's home, leasing is defined as "the transfer of property use by law for a limited period, followed by their return, the sale, including the sale agreement of the parties, or the return of goods or extension of use".

The first legal definition of leasing in Europe came from France, where the operation is called "credit-bail"¹.

The Law 64-455/1976² revised by the ordinance 67-837/1967³ defined in Article 1 the credit bail as the operation "by which a company gives real estate goods to be used on a professional basis, bought or built through its financial efforts, if these operations allow the lessee to become the owner, in whole or in part, of these assets leased no later than the contractual deadline...".

Currently, the French monetary and financial code (articles 313, 315 515, 571) provides the definition, advertising and operations of the credit-bail⁴.

Also, the leasing can be defined as a method of privatization, the state companies sold assets (machines, buildings, workshops) through real estate lease sales with final clause. The object of leasing operations expanded from the movable property to fixed assets (real estate leasing).

In Europe the leasing has a major importance, being the engine of European companies investments, especially SMEs, contributing to new jobs and promoting innovation.

According to statistics of Leaseurope (European Federation of Leasing companies) in 2012, 20% of investments of equipment in Europe were financed through leasing. Moreover, the lease

¹ Achim, M. V., *Leasing - o afacere de succes - concept, derulare, contabilitate, eficiență*, Economic Publishing House, Bucharest, 2005, p.43

² www.legifrance.gouv.fr/jopdf/common/jo_pdf.jsp?numJO=0&dateJO=19660703&numTexte=05652&pageDebut=05652&pageFin, accessed in 27.02.2014

³ http://www.legifrance.gouv.fr/jopdf/common/jo_pdf.jsp?numJO=0&dateJO=19670929&numTexte=09597&pageDebut=09597&pageFin= accessed in 27.02.2014

⁴ http://www.legifrance.gouv.fr/affichCode.do?sessionId=7CB7C5F0A21E8E13E7C3686CF5B371AF.tp&djo01v_1?cidTexte=LEGITEXT000006072026&dateTexte=20140303- accessed in 3.03.2014

for equipment and vehicles remained relatively steady over the past three years, while estate leasing decreased by over 30% in 2012 over the previous year⁵.

The lease analysis conducted for the period 2007 - 2012 was based on data from the Association of Financial Companies - ALB Romania, the data is interpreted by the author taking into account the economic and financial evolutions and trends in the analyzed period at European level (involving comparable data).

Lease Operations - Advantages and Disadvantages

The leasing is a complex operation that raises a lot of questions related to the legal nature. According to Romanian laws, the leasing is defined as “the transaction whereby one party, called the lessor, transmit for a specified period the right to use immovable assets to the user; the lessor undertakes to respect the user's option to purchase the asset, to extend the lease or to end the contractual relationship. The user can choose to purchase the property before the end of the lease if the parties so agree and if the user pays all obligations under the contract.

According to the reviewed International Accounting Standard IAS 17 “Leasing” the leasing is an agreement in which the locator transmits to the tenant in exchange of a payment or a number of payments, the right to use the good for an agreed period of time”.

From the economic point of view, the leasing is a financing transaction in which the lessor assures the necessary funds for the entire investment. In legal terms, the leasing is a complex agreement (contract) that allows a person to obtain and use a good, without paying the price immediately⁶.

According to the Romanian legislation, the leasing could be financial or operational.

The financial leasing is a 100 % a method of financing, involving the next steps:

- The selection, by the user, of the manufacturer or distributor of goods;
- The negotiation of the price and delivery conditions;
- Contacting the leasing company to buy the good and to establish the contractual conditions;
- Simultaneous completion of the contract of sale and purchase between the supplier and the lessor, and the lease agreement between the lessor and the user.

The financial leasing does not ensure maintenance and insurance of the goods, there is no option of premature cancellation of the location, and the property is fully depreciated at the end of the contract.

The financial leasing contract must fulfill one of the following conditions:

- The good is transferred to the tenant at the end of the contract;
- The locator has the possibility of buying the good during the contract;
- The period of the contract is at least equal with 80 % from the estimated life period of the good;
- The actual value of the payments during the contract is at least equal with 90 % of the market value.

The operational leasing provides both operational leasing and renting property's maintenance and insurance; these costs are included in rent equipment. For these reasons, operational leasing is also called maintenance leasing.

⁵<http://www.leaseurope.org/uploads/documents/press-releases/pr130321-Preliminary%20Leasing%20Market%20Results.pdf> - accessed in 1.03.2014

⁶ Brezeanu, P., *Finanțele personale în România*, C.H.Beck Publishing House, Bucharest, 2011, p.357

The operational leasing does not have the buying option, the risks and the benefits of the property title are not transferred. The locator will assume all risks resulted from excessive use, damages, theft of the good, so, he could increase the leasing payments in order to cover these risks. In most of the developed countries, this type of leasing does not require an advance payment; this is included in the rent.

According to Stancu Ion (Finance, 4th edition, 2007, p.918), there is another type of leasing, called *sale and leaseback*. In this transaction a company sells to a leasing company or to an investor its owned properties or goods at market value, and at the same time, completed a rental contract of specific goods in terms of financial leasing.

Like any economic operation, the leasing has advantages and disadvantages reflected at microeconomic and macroeconomic level.

The user has an easy access to advanced technologies, could simultaneously contract a bank loan, and from the accounting point of view, the main advantage is the recording of the leasing rates in the operational expenses.

In case of the contract failure or of user's temporary insolvency, the user can be followed to recover the leased asset.

For the suppliers, the leasing could lead to the export's increase, as well as making new customers by using the experimental leasing (the good is rented, and after a period of use, it can be bought).

At the macroeconomic level, the leasing could assure sectorial increases by new investments, production's stimulation and new jobs.

The main disadvantage of leasing consists mainly of improper use by the user of the asset and the related high costs of staff training and business counselling.

The leasing must be viewed in comparison to credit, when talking about financing decision. Both funding sources are operations performed on a contractual basis allowing individuals or legal entities to use a good for which the sponsor provides funds for the purchase. In both cases the user has to pay the leasing or credit rate, in accordance with the contractual terms.

The loan is usually a traditional financing source used by commercial banks.

In my opinion, the most important difference between the credit and leasing is that in a lease contract, the user becomes the owner of the property at the end of the contract period, while in credit contract the good is immediately given to the owner.

Referring to the form of the award, usually the credit is granted in cash, while the leasing demands the delivery of equipment to the user.

The level of funding is another element that distinguishes the two forms of financing: in credit the beneficiary contributes with a certain percentage of the investment, while in lease operations, the user is not using its own funds, which are fully given by the lessor.

The guarantees provided by the user are different: while the loan is used as collateral and the collateral mortgage, leasing guarantee is given by the ownership of the property. Other safeguards may be required depending on the leasing company's policy.

Theoretically, the lease is for individuals and legal entities. Practically, this financial service is more advantageous for legal entities, including major advantages as tax deductible interest payments and depreciation. In credit operations, accounting depreciation and interest are tax deductible within the limits set by the financial accounting legislation in force. Whether individuals or legal entities, the lease acquisition of goods is advantageous in terms of cash flow. The advantage lies in the timing of payment of the purchase price during the contract period compared to full pay for direct purchase. Installment purchase also requires a percentage

of interest, usually included in the price, which can vary depending on the sponsor agreed by the seller.

Another difference occurs when early payment is done. In a lease contract, the customer can not pay the price in the first year, as the law prohibits a lease to last less than one year. This limitation does not appear to credit loans, where customers are able to repay the loan early at any time during the contract.

The credit may be granted with a grace period (1-6 months), that is not subject to the lease.

The credit has the disadvantage of the existence of higher collateral costs such as enrollment in the electronic archive of guarantee contracts, issuing insurance bills, accident bills, etc.

In recent years, a new form of leasing has spread in industrialized countries: the staff leasing. This is a form of specialized staffing for certain periods of time, used especially by SME's. The advantages are especially for the enterprise, reducing bureaucracy (employment contracts, payment of wages, calculation and payment of taxes and contributions to the state) and labor law issues (annual leave and medical dismissal). For the employee the benefits consist of flexible working hours, higher earnings than in permanent employment, and also the increasing professional experience (work environment different from one enterprise to another, different organizational cultures).

The Leasing Market Analysis in Romania during 2007-2012

The Romanian leasing market follows the trend of the economic crisis. Following the decreasing trend of lease operations on an international level, the leasing market registered a dramatic decrease as follows:

Table 1. The leasing market in Romania

	- mil. Euro -				
INDICATOR	2007	2008	2009	2010	2011
TOTAL					
leasing, in which	4948	4818	1299	1121	1349
Vehicles	3361	3384	812	712	917
Equipment	1126	1082	256	238	339
Real estate	461	352	232	171	93

Source: The Non-Banking Financial Institutions Market in Romania – Annual Report 2012, issued by Financial Companies Association – ALB ROMANIA

In this period the leasing market decreased dramatically from 4948 million euro in 2007 to 1349 million euro in 2011. The huge decrease is registered in 2009, then the leasing market fall with 74 % as in 2008.

The analysis on good segments reveals that all three segments had high decreases: vehicles from 3384 million euro in 2008 to 917 million euro in 2011, meaning a 72, 9 % decrease in this period. The equipment registered a 787 million euro decrease during 2007 and 2011, meaning a 70% fall. The real estate segment has the same trend – 80 % decrease from 461 million euro in 2007 to 93 million euro in 2011.

In 2012, the leasing market increased by 1%, but has different evolutions of the three segments: equipment and vehicles registered a 3-4 % increase, while the real estate segment dropped by 42 %, from 93 million euro in 2011 to 55 million euro in 2012.

Table 2. The leasing market in Romania by good segments

INDICATOR	2007	2008	2009	2010	2011	2012
TOTAL leasing, in which	100	100	100	100	100	100
Vehicles	68	70	62	63	68	70, 2
Equipment	23	23	20	21	25	25, 8
Real estate	9	7	18	16	7	4

Source: the author's processing based on The Non-Banking Financial Institutions Market in Romania – Annual Report 2012, issued by Financial Companies Association – ALB ROMANIA

By analysing the leasing market from the point of view of good segment's percentage, we notice that vehicles segments have a constant trend during the analysed period, at a medium level more than 66 %.

Despite the huge decrease in absolute amounts, the equipment's segment registered an average level of 23 %. This trend is explained by the rate of growth of the Romanian economy as a whole in recent years and the need for modernization of Romanian industry, due to the requirements of EU Directives. The real estate sector holds between 4 % and 18% of the total leasing market, but the percentage analysis is not in concordance with the absolute figures. In 2009 the decrease was 120 million euro, meaning a 40% decrease, while in 2010 the decrease was 61 million euro (26 % decrease). While the development of the real estate is on a negative evolution, the sale and lease back contracts dedicated to the real estate area, represented an alternative source of financing for lessors had a positive trend. In this period the real estate segment's percentage in total leasing market increases from 7 % in 2008 to 18 % in 2009 and has a small decrease in 2010 (16%). This fluctuant evolution is related to decrease of the other two segments (vehicles and equipment). In 2010, the downward trend is apparent in all market segments leasing due to the increase of VAT, which resulted in freezing the investments and even the businesses.

In 2012, the equipment sector increased by 0, 8 %, the vehicles segment increased by 2,2 %, while the real estate segment losses 3pp against the previous year.

Table 3. The Romanian leasing market by contract's duration

INDICATOR	2007	2008	2009	2010	2011	2012
1 year	2	3	4	5	5	5
1-2 years	6	4	5	8	9	11
2-3 years	22	18	18	19	21	20
3-4 years	26	30	23	22	22	23
4-5 years	31	33	24	21	24	24
>5 years	13	12	26	25	19	18

Source: the author's processing based on The Non-Banking Financial Institutions Market in Romania – Annual Report 2012, issued by Financial Companies Association – ALB ROMANIA

We noticed that the largest numbers of contracts are in the 3-4 years segment and 4-5 years segment. In 2008 these segments reached 30 % and 33 %.

According to these figures, the users do not agree with the short contracts (1 year and 1-2 years). The trend is for the medium contracts, due to the fiscal incentives and the advantageous contract's stipulations.

The Romanian financial leasing market has registered in the first half of year 2012 a stagnation trend compared to the same period of the previous year. The total financing amounted to 649 million Euros (based on the value of the financed assets) covered 25% of the industrial

equipment, 3% of the real estate field and 72% of the transport segment. This breakdown of areas of interest proves that, despite the financial crisis, the financing of the economic agents focused on transport areas of activity remains one of the most confident markets.

The Romanian financial leasing market, in terms of lessors is dominated by the leasing companies owned by the big financial & banking groups. Thus, the biggest market quota is registered by the sector of the banks' subsidiaries, with 62% out of the total, followed by the captive companies sector with 24% and by the independent companies sector with 14%.

Due to fiscal incentives offered by the Romanian legislation mainly to lessors that are organized as economic agents, the legal clients attracted the largest part (90%) of the total financings, followed by the individuals (10%).

The leasing market's share into Romanian GDP shows a positive trend during the pre-crisis period and a negative one after the financial crisis. Thus, if in 2008, the first year of decline for this market, the penetration index is at 3.52% in 2011 this index has reached the level of 0.99%.

In 2012, the Romanian leasing market is 0, 49% of European leasing market, according to Leaseurope statistics for 2012.⁷

We are overcome by the traditional industrial countries - Germany, France, UK, Austria, where leasing is intensively used, but surpassed countries where market share is lower than in Romania (Bulgaria - 0.2%, Estonia - 0.38%, Slovenia 0.31%).

In 2012 the European leasing market followed a downward trend, the transaction volume was 2.6% lower than in 2011. The equipment sector remained relatively stable (+ 0.6%), while the real estate sector diminished by 32.3%.

The overall penetration index was 12.4% and 19.7% in 2012 to 19.5% in 2011 for equipment and vehicle segment. These segments have the largest share of the contracts (71.2%), Europeans preferring the original contract for a period of 2-5 years, with an average cost of 28,500 euro, down by 2% relating to 2011. For the second consecutive year, the real estate sector dropped, whereas the number of contracts decreased by 42.3%.⁸

Conclusions

From the second half of 2008 there is a decrease in the volume of transactions, a phenomenon accentuated in 2009 and 2010, due to the global economic crisis. The leasing market recorded a 70% decrease for the analyzed period for the three segments. In 2012 the total leasing market grew by 1%, but exhibited various trends in the three segments: equipment and vehicles increased by 3-4%, the real estate segment fell by 42%. The leasing market in Romania follows the European decreasing trend, but the European citizens intensively used the leasing as a financing source of the business.

If we weigh the most used two types of leasing, financial and operational, each has its advantages and disadvantages for both the leasing company and the recipient of leasing object. The leasing is a way to revive investments, facilitate attractive new financial resources, new channels for market promotion of limited demanded products and, also a way to raise some unproductive sectors of the economy such the agriculture.

Although the legal framework regulating the leasing and operations were repeatedly amended and supplemented, in our country there is a need for substantial improvement of the legal base on lease. Promoting operational leasing in several fields such as agriculture and industry would

⁷ <http://www.leaseurope.org/uploads/documents/stats/European%20Leasing%20Market%202012.pdf> accessed in 25.02.2014

⁸ <http://www.leaseurope.org/index.php?page=key-facts-figures> accessed in 25.02.2014

lead to upgrading equipment, more competitive economy reaching EU developed countries and increasing the leasing share in GDP.

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