

Financial Performance of Leasing Sector. The Case of Pakistan

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Abstract

Leasing, as the part of financial institutions, plays an imperative role in the countries economy development and growth and contributes a major share in the GDP by supporting in channelizing of funds. This objective of this study is to examine financial performance of leasing companies since 2008 to 2010. Ratio analysis technique has been used to evaluate financial performance of leasing companies. This study concludes that in 2010 the financial ratios are showing the positive change but there is a decline in financial performance of leasing companies in 2009 as compared to 2008.

Key words: Leasing, financial performance, SECP, State Bank of Pakistan, NBFCs.

1. Introduction

Financial system facilitates for funds mobilization to investors containing different components like monetary policies, financial markets, and financial instruments etc. State Bank of Pakistan (SBP) and Securities and Exchange Commission of Pakistan (SECP) has been taking many steps to improve the structure of financial instruments, credit quality, and payment system for betterment of financial system. Financial sector has many stakeholders according to banking view point like Non-banking Financial Institutions (NBFIs) and banking institutions. Non-banking Finance Companies (NBFCs), development Finance Institutions (DFIs), mutual funds and modarabas are the major components of NBFIs (SBP, Financial Stability Review, 2009-2010). NBFCs as a part of NBFIs provide many services like leasing, asset management, discounting, investment advisory and other which are notified by federal government (Companies Ordinance, 1984).

The purpose of this study is to know the financial performance of leasing companies in Pakistan. The idea of leasing was very ancient. It is an inventive way of getting machinery, equipment or other asset without paying the full amount upfront and profit is earned through the use of equipment not ownership. It can be defined as a written agreement between leasing company (lessor) and user of equipment (lessee) whereby the user of equipment agrees to pay a specified sum of money as rental to the leasing company over a specified period of time for the equipment owned by leasing

company. Since 1947, Pakistan has been taking many steps to strong the financial system of the country. Therefore, the first leasing company was established in Pakistan with the name of National Development Leasing Corporation Ltd (NDLC) in 1984 regulated by SBP till 2002 but from 2002 to onward SECP is the regulatory body of leasing companies. Initially, the reasons of lack in momentum of leasing industry growth and hurdles for development in Pakistan were the lack of awareness to the general public and corporations with reference to its benefits and nature, economics managers mismanagement, national wealth pilferage, increase in oil prices in the area of 1970s, international recession in 1980s and political instability and the total numbers of incorporated leasing companies from 1984 to 1989 were 9 which were raised to 35 from 1990 to 1999 and only one company was incorporated in 2003 (AFSA). Now many Modarabas, commercial banks, investment companies and investment banks are providing the leasing services and became the member of Leasing Association of Pakistan (LAP) and in 2000, there were 40 members of LAP which were the highest in total.

Table 01: Number of member entities of LAP

	Year		
	2007	2008	2009
Leasing Companies	17	15	11
Leasing Modarabas	5	5	4
Investment banks	4	4	3
Investment Companies	1	1	--
Total	27	25	18
Source: (LAP)			

Table 01 shows the total number of leasing companies from 2007 to 2009 which are providing the services of leasing in Pakistan and also are the members of LAP. The numbers of companies are decreasing year to year and according to financial stability review of NBFIs by SBP, there are only 9 leasing companies which are providing the services in 2010 (SBP, Financial Stability Review, 2009-2010). This decrease in number is due to the many reasons, which are (SBP, Financial Stability Review, 2009-2010):

- i. Many banks had started to provide the facility of car financing. Therefore, major companies have stopped its car financing operations;
- ii. Lower volume of business due to the economy slowdown;
- iii. Non-compliance with minimum equity requirements (MER);
- iv. High provisioning cost and high financial cost;
- v. More reliance on the borrowing from other banks and institutions; and
- vi. Competition with banking sector.

All the above mentioned reasons are directly or indirectly putting their effects on the performance of leasing companies in terms of profitability; share in NBFIs assets growth and number of entities etc. In Pakistan, most of the leasing companies are providing the three types of products, which are:

- i. Operating lease;
- ii. Corporate lease; and
- iii. Automobile lease.

Each product has some reasons from which the companies are getting the benefits for business. Operating lease is normally for less than one year and corporate & automobile lease normally contains the period of more than one year. There are two main advantages of leasing, which are:

- i. Leasing provides asset based financing as compared to collateral based financing; and
- ii. This mode of financing is accepted under Shariah rules.

Due to above mentioned advantages people are more interested in leasing because Shariah rules are applicable here and these advantages are not only for people but companies also attain many advantages. There are many reasons to finance the asset or machine through operating lease. The reasons are (SLCL):

- i. Aggressive credit approval;
- ii. Easy accounting treatment;
- iii. Technology risk alleviation;
- iv. Full service lease facilities;
- v. Flexible structure and terms;
- vi. Improved financial ratios;
- vii. Low capital budget requirement.

SECP, being regulatory body, has been taking many steps for the improvement of financial system and to increase the performance of leasing companies to solve the above mentioned problems faced by the leasing sector. SECPs' Specialized Companies Division (SCD) has two wings, NBFC-I and NBFC-II. The NBFC-I wing is accountable to look after the leasing, housing finance, and investment finance, whereas NBFC-II is responsible for the activities of asset management and asset advisory business. According to " Non-banking Finance Companies and notifies Regulations 2008", 20 percent of assets of such companies must be invested which are providing the services in combination of leasing, investment finance and housing finance and it is necessary to attain the license from the SECP to provide the services and if a company wants to provide only the leasing service then it is necessary to invest 70 percent of its assets but it shall not engage in the business of land and residential apartments and buildings (SECP, 21st November, 2008).

Table 02: Number of licenses held by leasing companies

Form of Business	Year			
	2007	2008	2009	2010
Leasing	19	18	15	14

Source: (SBP, Financial Stability Review, 2006-2007) (SBP, Financial Stability Review, 2007-2008) (SBP, Financial Stability Review, 2008-2009) (SBP, Financial Stability Review, 2009-2010)

Table 02 depicts the number of licenses held by leasing companies from 2008 to 2010. There is a direct relation exist between the number of companies and the number of licenses which means that as the number of companies decrease, the number of licenses also decrease and these licenses were renewed after one year but now SECP has changed this period from one year to three years by making the amendments in the " Non-banking Finance Companies (Establishment and Regulation) Rules, 2003" to solve the on-going concern issue raised by stakeholders and to save the renewal cost and time (SBP,

Financial Stability Review, 2009-2010). Before taking the license, it is necessary to meet with the conditions of minimum equity requirements (MER). In the beginning, Rs. 50 million was enough to start the business but limit was raised in 1992 to Rs. 100 million and in September 2000 the limit had raised to Rs. 200 million. Many efforts are made for strengthen of leasing sector and protection of stakeholders interest, a new schedule has issued by SECP regarding MER.

Table 03: Minimum Equity Requirements (MER) for Leasing Companies

Form of business	MER for fresh licenses	Time line for existing NBFCs as of 30 th June			
		2008	2009	2010	2011
Leasing	700	200	350	500	700

Source: (SBP, Financial Stability Review, 2007-2008) (SECP, 21st November, 2008)

Table 03 describes the MER for leasing companies. Till 30th June, 2008 capital should be Rs. 200 million, till 30th June, 2009 it should be Rs. 350 million, till 30th June, 2010 it should be Rs. 500 million and till 30th June, it should be 700 million.

Table 04: Equity of leasing Companies

Equity	Number of Companies		
	FY07	FY08	FY09
Over Rs. 2.0 Billion	1	1	1
Between Rs. 1.0-2.0 Billion	1	1	1
Between Rs. 0.5-1.0 Billion	2	3	2
Between Rs. 0.2-0.5 Billion	4	5	5
Less than Rs. 0.2 Billion	6	2	1

Source: (SBP, Financial Stability Review, 2009-2010)

Table 04 reveals that how many companies have the compliance with MER. In FY09, there is only one company which has the capital more than Rs. 2.0 Billion. Therefore, there is a chance of mergers and acquisitions of leasing companies with commercial banks and investment banks due to the non-compliance with MER. Many remedial measures should be taken to raise the capitalization, promote product innovation, recognized under developed segments, and market outreach enhancement to ensure the sustained growth. Now, leasing companies are going to enter through operating lease for harvesters, tractor lease and farm loans, in agriculture sector and focusing on micro financing.

This study has the purpose to evaluate the performance of leasing companies in Pakistan and ratio analysis is used containing three year period from 2008 to 2010 with motivated factors, which are:

- i. Researcher is unable to find the prior study in Pakistan on this topic in which ratio analysis is used to know the performance whereas a study has found on this topic in India. For example see Seem Saggar (1995). Therefore, researcher can called it as an exploratory research; and
- ii. To make it a source of knowledge for all type of investors to take the investment decisions.

2. Data and Methodology

All data has been retrieved from Securities & Exchange Commission of Pakistan (SECP), Asian Financial Service Association (AFSA), Leasing Association of Pakistan (LAP), State Bank of Pakistan (SBP), and leasing company's websites. Nine companies are selected for analyses out of fifteen and this study covers three year period (2008, 2009 & 2010).

First of all, financial statements of each company are downloaded from its web site than seven below mentioned financial ratios are calculated for three years (2008, 2009 & 2010) using these audited financial statements to know the financial performance. The ratios are:

- i. Profit after Tax / Total Assets
- ii. Profit after Tax / Total Equity
- iii. Dividend / Profit after tax
- iv. Total Borrowings / Total Assets
- v. Total Borrowings / Total Equity
- vi. C. Assets / C. Liabilities
- vii. Total Incomes / Total Expenses

3. Findings

Table 05: Financial Ratios of Leasing Companies

Financial Ratios of Leasing Companies				
Sr. No.	Ratios	2008	2009	2010
1	Profit after Tax / Total Assets	0.11	-0.79	-0.25
2	Profit after Tax / Total Equity	0.62	-7.57	-4.91
3	Dividend / Profit after tax	3.29	-0.62	0.58
4	Total Borrowings / Total Assets	3.64	2.41	2.37
5	Total Borrowings / Total Equity	18.26	29.45	24.51
6	C. Assets / C. Liabilities	11.07	11.52	14.68
7	Total Incomes / Total Expenses	10.41	5.83	9.36
Source: Companies audited annual reports.				

Table 05 depicts the findings in shape of ratios which are calculated from the audited financial statements of the leasing companies containing three years period of time. Comparative analyses of 2008 and 2009 shows the decrease in performance of leasing companies in 2009 because all the ratios are describing the declining trend in 2009 and ratios relating to profit after tax has turned negative due to the loss after tax in 2009 and the key performance indicators of leasing companies compiled by the SBP also showed the same trend in 2009 and this decrease in profitability is mainly due to the high financial expenses, competition with banking sector and high provisioning cost (SBP,

Financial Stability Review, 2009-2010) but in 2010 this situation is changing and the ratios show the positive results as compared to the 2009.

4. Conclusions

The performance of leasing companies in 2010 is better than the performance in 2009. The ratios regarding 2010 are showing positive change from 2009 but the performance was deteriorated in 2009. Our results are consistent with the reporting by SBP Satiability Review of Financial Sector. The number of leasing companies are gradually decreasing and minimum equity requirements (MER) has the major stake but the decrease in performance in 2009 is due to the high provisioning cost, high discount rate, high financial expenses, instability of economic conditions, political instability, competition with banking sector, separate regulatory body of leasing companies and commercial banks and high reliance on borrowing from other financial institutions.

It is suggested to allow the leasing companies to execute the business of land and residential apartments and buildings so that they can earn better profit and enable the small entrepreneur with financing and there should be only one regulatory body for leasing companies and banking sector so that the products and services could be different from each other. Some restrictions can be applied on banks or leasing companies regarding products and services if banks and leasing companies want to offer the same line of products and services. Results are based on the data of sample leasing companies by taking only three year period of time. For future studies, it is suggested that the time period and number of companies should be increased while considering leasing sector for financial analysis. Further, Pakistan is low income developing country and has specific local dynamics of leasing which are different from other countries so these results cannot be generalized for other developing countries.

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