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UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna International Centre, P.O. Box 300, 1400 Vienna, Austria
Tel: (+43-1) 26026-0 · www.unido.org · unido@unido.org

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LEASING - A METHOD TO COMBINE FINANCING AND MANAGEMENT RESPONSIBILITY[1/]

by

A. Schwab
AFCA
Geneva, Switzerland

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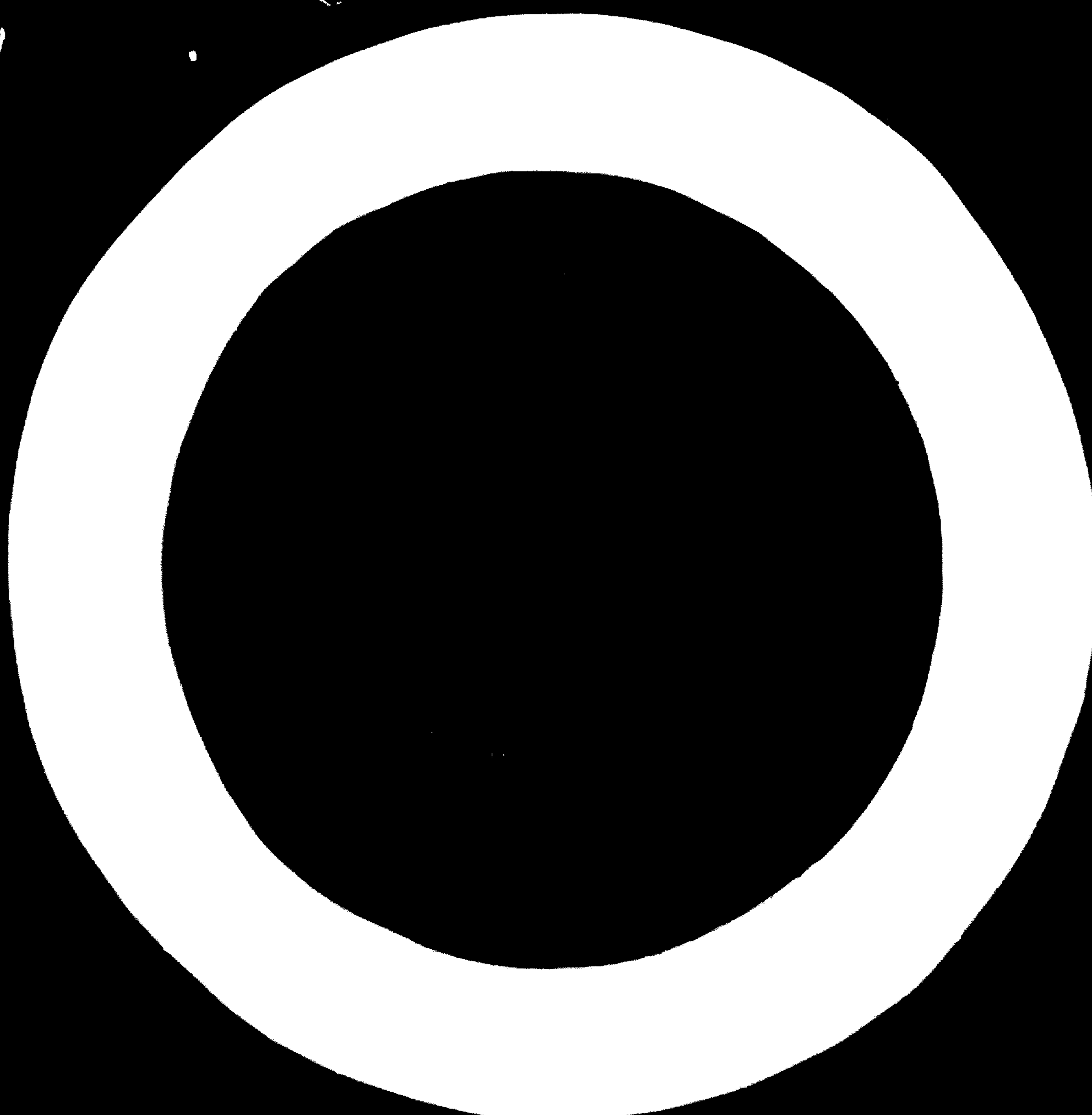


LEASING - AN EFFECTIVE TOOL TO LINK MANAGEMENT AND FINANCING

It is a great pleasure for me to have the opportunity of speaking to this distinguished assembly on the subject of leasing.

May I say right away that none of my remarks are intended to be the final word on the leasing concept. What I would like to do in the next few minutes is to indicate some of the basic guidelines on the subject - in the hope that it can later be thrown open to general discussion.

Leasing is not new, and I am sure some of you are familiar with its applications in various ways. In a very basic way we are all involved in it. Did you, for example, ever stop to think that your home telephone comes to you on a leasing basis? So does the apartment or the house you rent. So does the communal TV antenna of your roof, the ashcan that carries away your rubbish, and on a more commercial level, the electric typewriters and computers you hire for use in your offices. If you rent a TV set at home you are part of the leasing business. That boat you hired for your summer vacation - that was also an aspect of the leasing business. And I could go on with many more day-to-day examples... but I'm sure you've got the general idea.

The point I want to make is very simple. Leasing is something that affects us all in one way or another. We have a need which we cannot supply ourselves. What do we do? We find someone who can supply it. In other words, none of us is completely self-sufficient, whether it be on an individual level or an international one.

What therefore do we mean by leasing? Simply the supply of a specific object or service on a rental basis against payments on dates agreed by the contracting parties. On an international level, and particularly in the area of finance, investment, technical services and know-how, leasing has an importance and a potential that can hardly be over-estimated. As a method of bridging frontiers and promoting international trade, leasing is still in its infancy.

Leasing originated in the U.S., and like so many other innovations from that country, it gradually penetrated Europe. Today, it is an integral part of the commercial, industrial and financial life of the more advanced countries of Western Europe.

What are the advantages of leasing as a method of financing?

The rapide development of technology, in some cases advancing by leaps and bounds, and the impact of competitors on a free market compel enterprises to give optimum consideration to the means of production.

What is the use nowadays of a machine which, according to the official Alpha-rating, can be discarded as out-of-date in eight years' time, when it can be effectively used by an enterprise for only 4 or 5 years.

In this day and age of technological progress, the number of commodities which can be used for the totality of their effective life is constantly diminishing. As awareness of this became more prevalent a different approach to the question was adopted.

It is no longer the ownership of a given means of production which is decisive, but rather the effective use which can be obtained from it, as for instance, a piece of machinery.

Consequently, more and more firms see that leasing represents a means of conserving their capital and liquidity and are giving priority to using this method, thus enabling them to make their necessary capital investments.

Another favourable factor is that, as a general rule, up to now sufficient short-term credit was available to small and medium sized firms. However, for investment financing covering a period of 2 to 8 years the possibilities were limited. Here, leasing presented a means of rounding-out or supplementing the traditional methods of financing.

Possibilities of use

Nowadays, leasing can be obtained in practically every field; from computers to production plants, vehicles, solid waste incinerator plants, aircraft and even linen requirements for hotels and hospitals.

The size of the investments covered by existing leasing contracts varies from a few hundred to well over hundreds of millions of Dollars.

THE MOST IMPORTANT TYPES OF LEASING AND THE MOST SUITABLE ITEMS FOR LEASING

1. Maintenance-leasing

Maintenance-leasing covers both the delivery of the commodity and maintenance provided by the lessor.

To name a few :

- Computers	- IBM and others
- Private cars	- Volkswagen Ford-Leasing, etc.
- Lorries, trucks	- Henschel Leasing, etc.
- Earth-moving equipment	- Henschel Leasing, etc.

Maintenance-leasing, also called "full service leasing" is a sales and marketing procedure of the firm providing the equipment, etc., because many producers of such equipment are nowadays obliged to provide the means of financing purchasing at the same time as supplying the product.

2. Real Property Leasing

Real Property leasing includes:

- Factories . workshops
- Administrative and office buildings . schools .

- Gymnasiums . large stores . shops . emporiums
- Supermarkets . water purification and garbage disposal plants
- Power plants and separate heating plants for buildings, etc.

which are all supplied with leasing facilities.

In executing the above contracts the land on which the property is built is, as a general rule, purchased outright by the lessee company or entered into on a tenancy basis with a reversion clause. The tenancy period varies between 10 and 20 years.

In practice it often occurs that a real estate and property building firm and a property-leasing firm join forces in promoting a property project by means of a leasing contract.

It is also customary for real property leasing companies to intervene directly in the actual construction, planning and execution of the construction plans.

3. Finance-leasing

Thirdly, we have finance leasing, and I will deal principally with this matter in my subsequent remarks, since this is the type of leasing most commonly practiced .

Finance leasing consists in the handing over ot a piece of property or item leased without maintenance responsibility on the part of the lessee.

Finance leasing can be assumed to exist only if, under normal circumstances:

a) the contract is entered into for a fixed term, during which time it cannot be terminated or rescinded unilaterally by either party, as long as the contractual obligations are fulfilled (basic lease duration),

and

b) the lessor is liable, together with the instalments as they fall due, for coverage of any costs of acquisition or setting-up or installing the item, as well as incidental costs including the lessor's costs for financing the credit provided.

The criteria are therefore as follows:

- a basic fixed-term lease
- no unilateral termination by either contracting party and full amortization of the debt, including incidental costs connected with the item leased, within the basic lease period.

What machinery, plants and equipment are most suitable for finance leasing?

Basically, all machinery, plants and equipment which are movable are suitable for this type of leasing.

machine tools	vehicles
office equipment and machines	recipient-filling plants
textile machinery	printing presses
packaging machines	presses, moulding machinery
construction plants	automatic duplicating equipment
containers	lathes, etc.

DISADVANTAGES AND ADVANTAGES OF FINANCE-LEASING

1. Disadvantages (which can sometimes be avoided)

a) The lessee has no ownership or proprietary rights over the item leased, merely a righ to use the objec. The lessee is bound by the conditions of the contract.

b) Costs and cost analysis

Undoubtedly, lease financing is not inexpensive, when we consider that during the basic lease period, in addition to the interest costs, the entire debt must be paid off in full.

However, looking back on the circumstances of individual firms, and here I am thinking of the trends in costs, production and income, the price appears in an entirely different light. Every means of financing has its price, and so has leasing. The appraisal of costs versus use is a determining factor. The target for the use made of the item leased must be higher than the aggregate leasing costs, plus the firm's other overhead and operational costs involved. We must also consider that the rental is a gross price which includes the amortization or repayment of the debt by instalments, the cost fo the customary intermediate financing which would otherwise be necessary, plus insurance cove age and taxes; whereas in the case of the traditional interest rate on ordinary loans we must consider the latter as a net price, which does not encompass the above costs.

c) Danger of a badly-estimated investment

The danger of wrongly-planned investment exists in the case of leasing, as in the case of all other forms of financing. However, with less financial outlay (the ratio between the leasing repayment instalments and the overall coverage of financing costs), more machinery, plant and capital equipment can be provided. Only plant potential used to optimum capacity gives a long-term guarantee for the fulfilment of the contractual obligations. This is where the guidance and advisory services of the leasing company for its clients come in, and it performs a vital task in collaboration with the regular and private banks.

2. Advantages

a) 100% outside capital financial coverage; no outlay on the part of the lessee firm's own capital, no utilization of credit lines, non of the otherwise customary costs, and no pre-financing or intermediate or post-financing are required.

b) Protection of liquidity

The financial potential of the lessee is in no way affected by the actual investment itself. The liquid capital can be earmarked for the firm's own purposes, e.g. for more favourable purchasing opportunities, taking advantage of discount possibilities and obtaining rebates; funds for research and development; gaining access to new markets; increasing staff and sales promotion.

c) Optimum use of credit to its fullest extent

As a general rule no additional securities are required. The item itself which is leased is considered as security.

d) Safe basis for cost calculation

- fixed instalments
- no possibility of terminating contract unilaterally while in force.

e) Use and Financing

Strict attention is paid to the "golden rule of financing" according to which investment must be provided with full financial coverage, within the period during which the investment is required. Intermediate, pre- and post-financing are not necessary, with the consequent avoidance of cost increases and finance risks.

f) Continuous modernizing and rationalizing possibilities through instalment of the most up-to-date machinery.

INTERNATIONAL USE OF LEASING

In collaboration with UNIDO, my company recently carried out a market survey in Europe to establish what companies or organisations are using financial leasing as a tool in foreign financing.

Our task had three aims:

1. To identify which companies are currently using or planning to use leasing.

2. Development of a specific leasing concept which combines financing and management responsibility.

3. To establish what future steps will be taken in this area to expand the leasing concept.

On point (1) - companies now or planning to use leasing - we found that a surprising number of the largest industrial and commercial concerns and many of the leading banks, including merchant banks, are without practical experience in export leasing, although many of them have experience of leasing within their own countries and in their domestic activities.

All companies interviewed had no practical experience with export leasing. Most of the companies, however, were interested in the use of leasing if specific requirements could be organized to their satisfaction.

The following points were made by the interviewed companies as important:

- covering any export risk by sufficient guaranties

- sufficient size of a leased project in order to be able to recruit the necessary specialist and management

- leasing contracts clearly defined and internationally valid

- cost of leasing should not be too expensive for the partner in third countries
- higher margins of leasing contracts should not substantially influence the foreign currency situation of a developing country.

The above mentioned points indicate clearly that the interviewed companies were interested in the use of leasing, but had to face too many difficulties up to now in it's employment.

A favourable development, however, can be seen in the efforts of Export Insurance Companies (like HERMES KREDITVERSICHERUNGS AG) to agree on a formula how to cover export risks for exporting Companies.

LEASING AND MANAGEMENT RESPONSIBILITY

Despite these negative findings, I would like to say a few words on the subject of how leasing can be of benefit to both exporting and developing countries.

First, a few comments on the question of financing coupled with management responsibility. The financing of foreign investment (including those on a leasing basis) is naturally the daily tool for industrial involvement overseas. My intention is not therefore designed to outline a financial concept, but rather to develop a formula for the combination of financing and management responsibility.

Management responsibility is the key phrase in this context.

The basic concept is as follows and involves the following groups :

1. The foreign industrial group as supplier of equipment

2. The financial group as financier

3. Both groups as partners in a leasing Consortium

4. The lessee as the operating company in the country chosen for the investment.

The particular interest of the groups concentrates on the following points:

- The foreign industrial groups must have a concrete interest in the effective management of the project because they participate in the leasing profit margin.

- The financial group plays the vital role of linking the commercial development of the project with effective financial management.

- The country chosen for investment must be able to pay for the equipment out of production (leasing concept: pay when you earn).

- UNIDO is the instrument for the coordination of effort by all participants.

So much for the basic concept:

Now for operation and procedures.

As already mentioned, a Leasing Consortium is set up, consisting of the foreign industrial group and the financial group. The Consortium buys the production unit (equipment) from the industrial group at list price, less an amount which represents the capital investment of the industrial group in the Consortium, e.g. 20% of the full purchase price.

The financial group pays for its capital investment in the Consortium in cash. In other words: These capital investments represent payment for the production unit. The capital investment carries the risk.

A contract is drawn up between all participants which stipulates:

- the amount of capital investment for each
- interest on the capital investments
- distribution of net profit/net loss

The net profit/net loss is calculated according to :

leasing income
less: writing off of the production unit
interest payments
expenses

The annual leasing rent is calculated according to :

- interest on the investment
- write off of the investment
- profit margin
- other costs

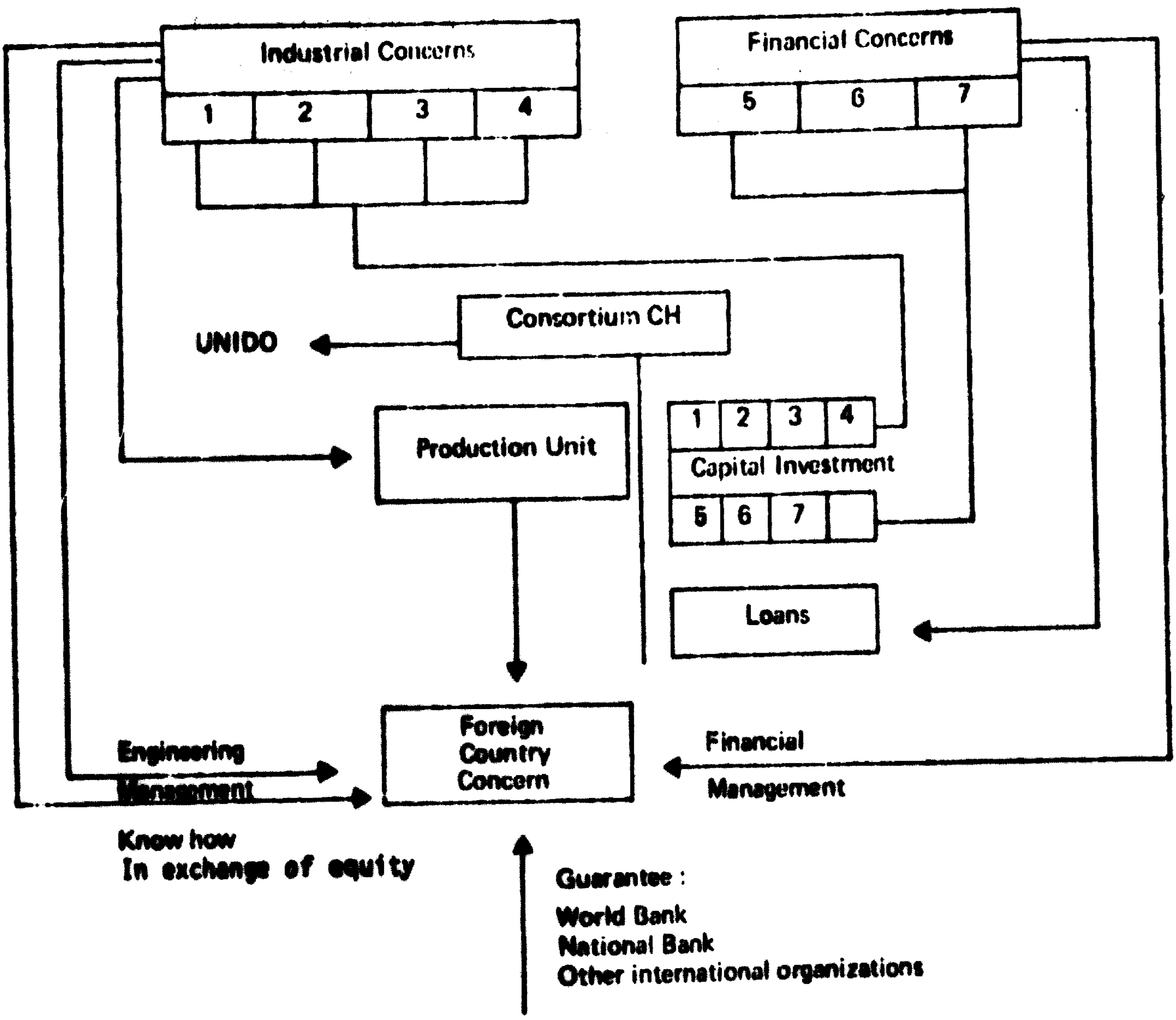
The major point of this calculation is :

The Management Assistance (industrial and financial group) is at the disposal of the developing country at no extra cost, because both groups receive compensation for their services through their share of the leasing profit margin.

At the expiration of the leasing period agreement, the property of the production unit is turned over to the client. Should the client furthermore desire to have members of the Consortium as partners in the operating company, this can be arranged on the basis of - for example - exchange of industrial/financial know-how against equity.

Not the least important aspect of this leasing concept is that all participants have a financial involvement which to some extent ensures active cooperation by all parties in overcoming the initial problems of starting a new project in a developing country.

STRUCTURE AND OPERATION OF THE BUSINESS



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