

## **Reasons behind the preference of lease financing over term loan by some of the borrowers in Bangladesh- An Investigation**

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### **Abstract:**

*Lease financing is getting importance as a mode of finance in the context of Bangladesh. Lease financing has some unique features that might be more favorable than other types of financing. The study has attempted to find out the reasons for the preference of lease financing over term loan by some of the borrowers in Bangladesh. Factor analysis has been used to identify the correlated variables for the preference of lease financing over bank loan. From the overall factor analysis (Borrowers who take lease from banks as well as from leasing companies), it has been revealed that under first factor the correlated variables are less procedural complexity for lease financing, fewer documentation and submission of documents in one package and avoidance of many restrictive covenants. The percentage of variation is 14.10. First factor has been named as Hustle Free Access. The advancement of leasing business will assist to extend the economic development of Bangladesh.*

### **Introduction**

The financial system of Bangladesh is rising progressively and the significance of lease financing is increasing day by day. Lease financing has some unique characteristics that might be more advantageous than other types of financing. At the time of taking investment decision, lease financing can be considered as an important alternative source of financing. The growth of small and medium enterprises (SME's) has a positive impact in the growth of output and employment creation in the context of a developing country like Bangladesh. Lease financing could play a vital

role to solve the financing problem for SMEs. Among the leasing companies in Bangladesh IDLC of Bangladesh, United Leasing, and, Phoenix Leasing Co. Ltd. are the most important ones. The leasing companies in Bangladesh are not only providing leasing activities but also are involved in stock market connected activities such as underwriting, issue management, private placement, trust management, portfolio investment and, mutual fund operation(1). Leasing companies in Bangladesh have some difficult issues. These issues are high cost of fund, asset-liability mismatch,

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sources of funds, investment in high risk portfolio, competition with banks, lack of human resources, weak legal system, lack of secondary market, etc (2). Leasing companies in Bangladesh are performing capital market operations like corporate counseling, bridge financing, capital restructuring, financial engineering, lease syndication, etc. Different sectors of Bangladesh are taking lease financing services. Transport, construction and engineering, paper and printing, pharmaceuticals, food and beverage, chemicals, leather and leather products, telecommunication, agro based industries are the different sectors which have taken the services of lease financing (3).

Despite charging higher interest rates (Accounting law, BAS-17, has made the financial lease to be considered as on balance sheet item. Lessors have to provide annual statement of interest to the lessee for accounting purpose), some of the borrower prefer lease financing than term loan. Collaterals are required in case of bank loan. Lease financing could play a vital role to solve the financing problem. Leasing institutions could provide fast services that might not be possible for banks and financial institutions. Quick documentation and fast decision making enable the leasing institutions to become popular gradually in Bangladesh. In case of lease financing, no secondary security is required. No third party guarantee is needed for lease financing. Consequently, Lease financing is becoming popular gradually in Bangladesh.

### **Objectives**

The objectives of the study are-

- 1) to identify the reasons for the preference of lease financing over term loan by some of the borrowers in Bangladesh.
- 2) to identify the correlated factors and variables for the preference of lease financing over bank loan by some of the borrowers in Bangladesh by using factor analysis.

### **Methodology**

Primary data have been used in the study. Interviews of 60 high officials of sampled banks and leasing companies have been taken to identify the reasons for preference of lease financing over term loan by some of the borrowers in Bangladesh. M.D/D.M.D of randomly selected 15 banks and 15 leasing companies have been asked about different questions related with the objective of the study. 30 persons from 15 leasing companies of which 2 persons from each leasing company and 30 persons from 15 banks of which 2 persons from each bank are selected for the key-informants interview.

The total of 405 firms' responses have been taken to detect the correlated factors and variables in factor analysis. These firms were given a questionnaire consisting of 14 questions asked to rank these questions. From their ranking, factor analysis has been used to find out factors related to the preference of lease financing over term loan and their correlated variables. Out of 405 firms, 300 firms have taken lease financing from the leasing companies and 105 firms have taken lease financing from banks. Overall factor analysis, factor analysis for those firms which have taken lease financing from the leasing companies and factor analysis for those firms which have taken lease financing from banks are used in the study.

**Factor analysis**

Factor analysis is a multivariate statistical technique that addresses itself to the study of interrelationship among a total set of observed variables. The technique allows looking at groups of variables that tend to be correlated to one another. While in multiple regression model, one variable is explicitly as dependent variable and all the other variables as predictors; in factor analysis all the variables are considered as dependent variables simultaneously. In a sense, each of the observed variables is considered as a dependent variable that is a function of some underlying, latent and hypothetical set of factors. Conversely, one can look at each factor as dependent variable that is a function of the observed variables. Several methods are available in literature to estimate factor loadings and factor scores. The study considers principal component method to estimate the factor loadings. Rotations method like 'Varimax' is adopted to find better estimates of factor loadings.

**Reasons for the preference of lease financing**

Acquisition of long-term assets requires huge cash outlay which is sometimes not possible for the user because of lack of financial capability. In such a situation, the user can lease such capital assets. Leasing serves as a long-term funding that could be used for the attainment of capital assets. A leasing arrangement provides a firm with the use and control over the assets without incurring huge capital investment. It requires only making periodical rental payment.

It has been found that acquirement of assets under leasing arrangement is cheaper and faster as compared to acquisition of assets through other sources of financing. Leasing provision enables the lessee to use more of its own funds for working capital purposes instead of using low yielding fixed assets. Acquirement of assets through a leasing arrangement is particularly beneficial for small firms which cannot raise funds to acquire assets because of lack of financial resources. The financial institution when lending money usually attach several restrictions on the borrowers as regards management, debt-equity ratio dividend declaration etc. These restrictions are not present in the case of lease financing. In recent times, leasing for business needs such as business equipment has become gradually more popular at many banks as more and more customers discover its advantages. It is easy to predict and budget for lease payments because of equal monthly payment. An important reason for the appeal of leasing is its flexibility. Business organizations can use leases for everything from equipment, to structures, to vehicles. It is possible to match the lease terms to the useful earning life of the equipment or facility and to choose the type of payment plans that match the unique needs, ranging from monthly to annually.

The reasons for the preference of lease financing are as follows:

1. Provision of collateral
2. The time of lease repayment
3. E.M.I ( Equal Monthly Installment) for lease
4. Longer grace period for lease
5. No secondary security for lease
6. No third party guarantee for lease
7. Lack of funds to choose lease financing
8. Faster service for lease financing
9. Less procedural complexity for lease financing

10. Fewer documentation and submission of documents in one package.
11. Avoidance of many restrictive covenants
12. Lease financing for low cost assets
13. Sale and leaseback arrangements
14. Total financing for lease

**Table 8.1: Overall Factor Analysis**

	Factor					
	1	2	3	4	5	6
Causes for the preference of lease financing over term loan						
provision of collateral						.807
The time of lease repayment						-.637
E.M.I (Equal Monthly Installment) for lease			.500			
Longer grace period for lease			.717			
No secondary security for lease			.611			
No third party guarantee is required for leasing.					.889	
Lack of funds to choose lease financing		.626				
Faster Service for Lease Financing		.510				
Less procedural complexity for lease financing	.775					
Fewer documentation and submission of documents in one package.	.759					
Avoidance of many restrictive covenants	.647					
Lease financing for low cost assets		.668				
Sale and lease back arrangements				.820		
Total Financing for Leasing				.568		
Eigenvalue	1.98	1.51	1.40	1.21	1.18	1.15
Percentage of Variation	14.10	10.79	10.03	8.63	8.39	8.24
Cumulative percentage	14.10	24.89	34.92	43.56	51.95	60.19
<b><i>KMO=0.618 &amp; Only Factor loadings ≥ 0.40 has been shown in the Table</i></b>						

The above factors can be named as first factor, second factor, third factor, fourth factor, fifth factor and sixth factor. The result suggests that these factors are mainly responsible for the preference of lease financing over term loan. According to the priority of the factors only the first four factors have been named. Under first factor the correlated variables are less procedural complexity for lease financing, fewer documentation and submission of documents in one package and avoidance of many restrictive covenants. The percentage of variation is 14.10. It means these three variables explain 14.10% of total influencing variable. These three variables actually indicate hustle free

procedural methods of lease financing. So this factor can be named as **Hustle free Access**. Under second factor-lack of funds to choose lease financing, faster service for lease financing and lease

financing for low cost assets are correlated variables. The percentage of variation is 10.79. Second factor can be named as **Small fund and low transaction cost orientation**. Third factor is correlated with these variables- E.M.I for lease, longer grace period for lease and no secondary security for lease. The percentage of variation for third factor is 10.03. Third factor can be named as **Friendly repayment privilege**. Under fourth factor the correlated variables are- sale and leaseback arrangements and total financing for leasing. Percentage of variation is 8.63.

The fourth factor can be named as **Recurring and complete financing facility**. Variable-no third party guarantee is required for leasing is correlated with fifth factor. The percentage of variation is 8.39. Provision of collateral and the time of lease repayment- are correlated variables with sixth factor. The percentage of variation is 8.24.

**Table 8.2: Factor Analysis for Banks**

	Factor				
	1	2	3	4	5
Causes for the preference of lease financing over term loan					
provision of collateral				.840	
The time of lease repayment				-.601	
E.M.I (Equal Monthly Installment) for lease	.726				
Longer grace period for lease	.667				
No secondary security for lease	.556				
No third party guarantee is required for leasing					.901
Lack of funds to choose lease financing			.596		
Faster Service for Lease Financing			.439		
Less procedural complexity for lease financing		.466			
Fewer documentation and submission of documents in one package		.583			
Avoidance of many restrictive covenants		.665			
Lease financing for low cost assets			.765		
Sale and lease back arrangements		-.710			
Total Financing for Leasing					.453
Eigenvalue	1.92	1.88	1.63	1.48	1.30
Percentage of Variation	13.74	13.46	11.65	10.57	9.30
Cumulative percentage	13.74	27.20	38.85	49.43	58.74
KMO=0.575 & Only factor loading $\geq 0.40$ has been shown in the Table.					

The above factors can be named as first factor, second factor, third factor, fourth factor and fifth factor. The result suggests that these factors are mainly responsible for the preference of lease financing over term loan. This is the factor analysis of those firms which have taken lease financing from the banks. Under first factor, the correlated variables are E.M.I for lease, longer grace period for lease and no secondary security for lease. The percentage of variation is 13.74. It means these three variables explain 13.74% of total influencing variable. First factor can be named as **Friendly repayment privilege**. Under second factor-less procedural complexity for lease financing, fewer documentation and submission of documents in one package, avoidance of many restrictive covenants and sale and lease back arrangements are correlated variables. The percentage of variation is 13.46. Second factor can be named as **Hustle Free Access**. Third factor is correlated with these variables- lack of funds to choose lease financing, faster service for lease financing and lease financing for low cost assets. The percentage of variation for third factor is 11.65.

Third factor can be named as **Small fund and low transaction cost orientation**. Under fourth factor the correlated variables are- provision for collateral and the time of lease repayment. Percentage of variation is 10.57. The fourth factor can be named as **Favorable terms of financing**. The variables-no third party guarantee is required for leasing and total financing for leasing are correlated with fifth factor. The percentage of variation is 9.30.

**Table 8.3: Factor Analysis for Leasing Companies**

	Factor					
	1	2	3	4	5	6
Causes for the preference of lease financing over term loan						
provision of collateral			.755			
The time of lease repayment		.650				
E.M.I (Equal Monthly Installment) for lease		.548				
Longer grace period for lease					.562	
No secondary security for lease					.816	
No third party guarantee is required for leasing						.881
Lack of funds to choose lease financing		.500				
Faster Service for Lease Financing	.451					
Less procedural complexity for lease financing	.821					
Fewer documentation and submission of documents in one package	.763					
Avoidance of many restrictive covenants	.649					
Lease financing for low cost assets			.431			
Sale and lease back arrangements				.824		
Total Financing for Leasing				.444		
Eigenvalue	2.13	1.36	1.35	1.28	1.24	1.19
Percentage of Variation	15.25	9.73	9.67	9.18	8.89	8.55
Cumulative percentage	15.25	24.98	34.66	43.84	52.74	61.29
KMO=0.585 & Only factor loading $\geq 0.40$ has been shown in the Table.						

The above factors can be named as first factor, second factor, third factor, fourth factor, fifth factor and sixth factor. The result suggests that these factors are mainly responsible for the preference of lease financing over term loan. This is the factor analysis of those firms which have taken lease financing from the leasing companies. Under first factor, the correlated variables are faster service for lease financing, less procedural complexity for lease financing, fewer documentation and submission of documents in one package and avoidance of many restrictive covenants. The percentage of variation is 15.25. It means these four variables explain 15.25% of total influencing variables. First factor can be named as **Less transaction cost and procedure for financing**. Under second factor-the time of lease repayment, E.M.I for lease, lack of funds to choose lease financing are correlated variables. The percentage of variation is 9.73. Second factor can be named as Favorable repayment scope. Third factor is correlated with these variables-provisions of collateral and lease financing for low cost assets. The percentage of variation for third factor is 9.67.

Third factor can be named as **Collateral free small funding facility**. Under fourth factor the correlated variables are- sale and lease back arrangements and total financing for leasing. Percentage of variation is 9.18. Fourth factor can be named as **Recurring and complete financing facility**. The variables-longer grace period for lease and no secondary security for lease are correlated with fifth factor. The percentage of variation is 8.89. No third party guarantee is required for leasing- is correlated variable with sixth factor. The percentage of variation is 8.55. The cost of fund of banks is less than the cost of funds of leasing companies. As a result, banks can provide leased asset by charging lower rental lease payment as compared to leasing companies. The borrowers from the banks give priority for E.M.I to take lease from banks because they need to pay lower lease rental as compared to borrower from leasing companies. Hence, the variable of E.M.I comes in the first factor in the factor analysis of banks. The variable of E.M.I comes in the second factor in the factor analysis of leasing companies. The borrowers from leasing company need to pay higher lease rental than the borrowers from banks. The borrower from leasing companies give more emphasis on transaction cost and procedure related reasons while acquiring lease assets from leasing companies. Hence, the variable of E.M.I comes in the second factor in the factor analysis of leasing companies. The variable E.M.I comes in third factor in overall factor analysis. The other factors have got more priority when we consider overall factor analysis.

## Conclusion

The popularity of lease financing is increasing gradually in Bangladesh. Leasing companies should reduce the service charges to enhance the leasing business in Bangladesh. Advertisement expenses should be increased by the leasing companies. To increase the use of lease financing transaction cost needs to be minimized. They should try to reduce the risk of obsolescence of machines and equipments. They should provide more flexibility to the customers. The leasing companies should try to accumulate capital from the capital markets. The government should improve proper guidelines and instructions for leasing companies to improve the leasing business in Bangladesh.

## References

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