

BANGLADESH LEASING & FINANCE COMPANIES ASSOCIATION



Inaugural Ceremony

APRIL 4, 2001



M. Aminul Islam, Chairman, BLFCA

It is an occasion of great significance that the Bangladesh Leasing and Finance Companies Association (BLFCA) is holding its Inaugural Ceremony. BLFCA is the representative body of all leasing and finance companies in Bangladesh. The main objective of the Association is to promote the interest of the Non-Banking Financial Institutions (NBFI) in carrying out their business and make interactions with regulatory bodies on various issues related to leasing and investment activities.

Leasing in Bangladesh is comparatively a new concept. The first leasing company was set up in 1985. With the passage of time at present there are 23 leasing companies. The growth of this sector is most phenomenal and indicates the acceptability of this new concept in the financial market. Almost every sector has its own trade body. To reap the benefit of operating from a common platform the leasing and finance companies felt the urgent need to form an association and thus BLFCA was formed.

On this occasion, I would like to extend my heartfelt thanks and gratitude to my colleagues in the Executive Committee, esteemed members of BLFCA, sponsors and all those who have made the event a grand success.



Y. C. Chen, President, Asian Leasing Association

It is my pleasure as well as the pleasure of Asian Leasing Association to know about official inauguration of Bangladesh Leasing & Finance Companies Association on April 04, 2001.

Bangladesh has been an active member in the Asian leasing community. The official inauguration of the Association reflected the success of its members in Bangladesh as well as the recognition of their contribution to the national economy.

It is not just my personal belief but also the belief of all other members of Asian Leasing Association that Bangladesh Leasing & Finance Companies Association (BLFCA) will be one of the leading and most influential trade association in the country.

Best regards to all members of the BLFCA and to the people of Bangladesh.

Profile

Bangladesh Leasing & Finance Companies Association (BLFCA), a representative body of Non-Banking Financial Institutions (NBFI) of the country was accorded license from the Government and has been registered with the Registrar of Joint Stock Companies and Firms on January 05, 1999.

The prime objective of BLFCA is to aid help, encourage, advise, promote and develop in Bangladesh or else where the business of financing enterprises and to provide advisory consultancy services to other entities or finance wing of other entities. It also protects the interest of the companies engaged in financing and leasing.

BLFCA envisages to serve as a forum for interaction among the Non-Banking Financial Institutions (NBFI) on matters which directly or indirectly affect the industry and to act as the official voice of the sector.

Members

Bahrain Bangladesh Finance & Investment Co. Ltd.
Bangladesh Finance And Investment Company Limited
Bangladesh Industrial Finance Co. Ltd.
Bay Leasing & Investment Limited
Delta Broc Housing Finance Corporation Limited
GSP Finance Company (Bangladesh) Limited
Industrial Development Leasing Company of Bangladesh Limited
Industrial Promotion and Development Company of Bangladesh Limited
International Leasing And Financial Services Limited
National Housing Finance And Investments Limited
Phoenix Leasing Company Ltd
Prime Finance & Investment Limited
United Leasing Company Limited
Uttara Finance and Investments Limited
Vanik Bangladesh Limited

Executive Committee

Chairman
M. Aminul Islam

Vice-Chairman
A. Quadir Choudhury

Member
M. Mahbul Alam
Sayeed Hossain Jamal
Feroz U Haider
Mafizuddin Sarker
Tapan K Podder
Azadur Rahman Khan

LEASING IN BANGLADESH - Problems & Prospect

Leasing, as a financial intermediary, is a relatively new phenomenon in Bangladesh with Industrial Development Leasing Company Ltd. (IDLCL) kick-starting this business in 1985 followed by United Leasing Company in 1989 and Phoenix Leasing Company Ltd. in 1995. Thus in a span of about 10 years three leasing companies were licensed to operate. So long the financial market was dominated exclusively by the Nationalized Commercial Banks (NCBs), Development Financial Institutions (DFIs) and Specialized Financial Institutions like HBFC, ICB and BKB in term lending operations. The emergence of Non-banking Financial Institutions (NBFI) opened new avenues for an alternative source of financing. Thereafter, more companies have been licensed and at present there are 24 financial institutions, previously known as NBFI, licensed by Bangladesh Bank as against 49 Banks including NCBs, DFIs and private and foreign banks.

Mushrooming of NBFI's be rationalized

The question that hovers over is; has the financial market expanded to absorb such large number of banks and financial institutions? Is the scale of the economy is so widely dispersed and diversified as to allow mushrooming of such a large number? Needless to mention that banks, financial institutions and industrial conglomerates in the countries around the region and across the world are in the throes of mergers and acquisitions. There is a syndrome of economic slow down in the developed and the emerging economies. The murky political scenario in the Asian economies in particular with even Japan in serious economic stagnation for about a decade followed by Thailand, Korea, the Philippines, Indonesia and Malaysia, except China, after the melt down of 1997 does not give good augury for healthy inflow of foreign investment that could trigger growth in the region including Bangladesh. Even shady clouds seem looming large over the political horizon of India. Under such circumstances it is high time for us to ponder and put a brake on expansion and focus more on consolidation and speeding up reforms to make the financial sector more efficient and competitive to integrate with the regional economy in particular and global economy in general.

Impact of the withdrawal of tax exemption and initial depreciation

The leasing companies, it may be mentioned, in consideration of the very nature and peculiarities of their business, were allowed, initially, tax exemption for a period of 5 years and initial depreciation up to 25%. But their honeymoon period seems to be over following withdrawal of tax exemption and dispensation of the benefit of initial depreciation by the Finance Act of 1998. Very few people seem to bother about their deeper implications on this nascent industry. Since leasing is a new concept in Bangladesh this sector should have been allowed sufficient timeframe to stand on its own feet but unfortunately many people in the top notch seem least bothered about the far-reaching consequences of such regulations and try to draw parallel between leasing and banking causing serious damage to this otherwise potential sector.

Banks by doing leasing are creating distortion in the market

Besides the above, the intermediation by the banking sector to do leasing business under the same roof of banking with their cheaper fund and perhaps not the level of expertise as the leasing companies have, are also causing more damage and distortion to the market segment of this sector. It may not be out of place to mention that banking sector should focus their attention more on marketing their own banking products and services rather than encroaching on a new and unfamiliar product like leasing which is relatively new in Bangladesh compared to banking which is as old as 100 years. The areas of activities of the leasing sector is much smaller and more restricted compared to banking which has multifaceted activities and numerous sources of income stretching over almost all segments of the economy such as trading, import-export, industrial finance, rural credits, remittance-inland & foreign, inter-bank lending and host of other fee (commission) related business. Thus it will be more in order for the banks to engage themselves in their own areas of business and pave the way for even and healthy growth of both the sectors.

Purported misinterpretation of the word EZARA by the Banks

The commercial banks are understood to have taken an advantage of the Bangla word 'EZARA' under section 7 DA (4) of the Bank Companies Act 1991 as financial leasing. But the very thesis and spirit of the word 'EZARA' allowing financial leasing by the banks, do not seem to hold good after the NBFI Act 1993 have been passed allowing emergence of Non-Banking Financial Institutions as separate entities to do leasing and such other jobs. However, we feel that the banks, willing to do leasing, may do so by having separate legal entity as required under the above act which stipulates obtaining of specific license for doing leasing or non-banking financial activities. But the banking companies seem to be doing leasing business without obtaining any license from proper authority. Under the circumstances, it may be argued with some measure of justification that if the banks are allowed to do leasing the NBFI should also be permitted to do banking and enjoy the facilities of banking system at least in a limited scale.

Scenario of NPAs of banks and the leasing companies

The average percentage of non-performing loans of the banking sector is about 35% of their total portfolio as against 5% of the leasing companies. We are afraid, the default culture of the banking sector may also infect the leasing sector if banks are also allowed to do leasing. Moreover, the recovery process of the banking companies are totally different from that of leasing. While loan installments are recovered by the banks on quarterly/half yearly basis the leasing companies recover their rent

installments monthly and also calculate depreciation on their leased assets on monthly basis. Therefore, the banking system does not look geared to the intensive monthly recovery process needed to leasing business.

Impact of fund cost and paucity of fund of the leasing sector vis-à-vis banks

It is pertinent in this connection to mention also the main sources of funding for the leasing sector which are:

1. Loan from the commercial banks
2. Term Deposit from the public
3. Fund from the capital market by way of issuing shares, debentures bonds etc.
4. Loan from foreign agencies

The deposit from the public is not encouraging for various reasons. In absence of a fully functional capital market in the country raising of fund from debt market has become a distant possibility. Similarly in the absence of any exchange fluctuation absorption scheme it is highly risky to take any long-term foreign currency loan. Therefore, the only effective source of funding for the NBFI is the credit lines from the commercial banks at a very high rate of interest ranging up to 15%. With such a high fund cost it is well nigh impossible for them to compete with the banks and the lease rates of the leasing sectors are gradually becoming unattractive to the entrepreneurs. On the other hand, the sources of funds for the banks are varied and cheap enabling them to offer relatively lower rate of interest over the leasing companies putting them in a very disadvantageous situation resulting in the creation of an uneven playing field and making the future of this sector quite bleak.

Structure of fund cost of the banking sector vis-à-vis leasing

Over and above this situation the banking sector is better placed than the leasing sector in terms of cost of fund and availability of fund and their scope and areas of activities. About 15% of the deposit of the banking sector is reported to be demand deposits which are interest free while 35% constitute low cost saving deposits averaging at 4%-5% interest rate and the remaining is fixed deposits averaged at 9% thus bringing the weighted average fund cost for the banks to hardly at 7%-8% which is less than half of leasing companies. Thus the fund cost and paucity of funds are two major drags on the growth of this sector. In spite of such adversities the NBFI have executed lease contracts (Lease Finance) to the tune of Tk. 486 crore from 1st January to 31st December 2000 which can almost be doubled if their fund cost problem can be reduced to market level. The CBSF project of the World Bank, supposedly working for assisting the NBFI in easing their fund problem seems to be moving at a very snail's pace. During the last two years a series of meetings were held but nothing has been done to ease the fund problem. The earlier this problem is resolved the better it will be for the leasing sector as a whole.

Remedial measures to ease the funding constraints of the NBFI

In order, however, to ease the chronic and burning problem confronted by the sector I would like to take the privilege of suggesting the following as remedial measures. That, Bangladesh Bank may:

- i) Create a separate RE-FINANCING window for the leasing sector on roll-over basis under certain clearly spelled out policy guide lines basing on the capital structure, EPS position, flow of disbursement, recovery performance, management skill etc. or
- ii) Allow VENTURE CAPITAL for the leasing sector to be repaid over a period of time from their rent receivables in consideration of their good recovery performance or
- iii) Allocate a BASKET OF FUND for NBFI for purchasing treasury bills against which they may draw equal amount for meeting their working capital requirement to be repaid over a period of time. This will help securities the loan on the one hand, expand the bill market on the other and reduce the fund cost of the NBFI.

Any of the above measures, if worked out, will go a long way in mitigating the working fund problem of the NBFI and help them reach larger segments of the clientele they have been desperately longing for.

NBFI's a new trend setter in recovery

Since the leasing companies have their reputation already well established with their other lenders as excellent performer with the overall recovery at around 95%, Bangladesh Bank, we hope, should not have any reservation in extending their helping hand to this potential sector especially when they are also keeping CRR, SLR and other statutory reserves in compliance to their instructions almost in line with the commercial banks. In the back drop of such a situation if the banks can enjoy refinancing facilities from the central bank the NBFI it may be reasonably argued, deserve some amount of considerations to ease their financial constraints in view of their having performed so well. The sector has equipped itself with well educated, forward looking, market driven and consumer friendly brand of executives who are showing their skills and professional acumen in all spheres of their activities.

Potential areas of investment by the Leasing Sectors

Leasing Sector in Bangladesh has identified the following as the potential areas for financing:

1. Capital Machinery
2. Heavy Construction Equipment
3. Transport of all kinds both road and marine including commercial vehicles

- like bus, truck, minibus, pickup, car etc.
4. Information Technology (IT)
 5. Energy and power
 6. Air conditioning plants & equipment
 7. Medical & diagnostic equipment
 8. Tractors, trailers, power tillers
 9. Consumer durables

Finance lease is full - pay-out lease : its implications

The leasing sector even provides for 100% funding of the leased asset. The documentation procedure in leasing is simple and less cumbersome than in banks. Leasing as practiced in Bangladesh is finance lease which is "full-pay-out lease" in which the legal ownership of the assets are retained by the lessor (leasing company) while the lessee remains as the user with obligation to keep the leased assets under proper maintenance. After payout of the value of the asset the lessee is left with any of the following three options:

- i) renew the lease on a year-to-year basis at a pre-determined rental or
- ii) return the equipment to the lessor or
- iii) purchase the equipment at a residual value

Under the finance lease the lessor recognizes its asset as a financial investment and accounts for the interest according to an actuarial method. Thus industrial plant, machinery and construction and office equipment are financed predominantly by lease finances. For many small and medium sized enterprises with limited access to traditional bank facilities, leasing and asset financing remain the only available source of funding.

Off balance Sheet financing and tax incentive of lease contracts

The lease rentals made by the lessee are entirely deductible for tax purposes as rentals which constitute both principal and interest and are treated as revenue expenditure providing thereby greater tax incentive packages compared to borrowing from banks where only the interest component is tax deductible. The leased asset, it may further be mentioned, can be acquired without recording the lease obligations as liability in the balance sheet since the leasing company owns the asset. The lease transactions are structured in a certain way that "the lessor retains the financial risks and rewards" and thus the transaction and equipment are not on the financial statements of the lessee.

Leasing companies should now diversify their products

Leasing companies in Bangladesh have still their niche in equipment leasing. Time has come for them to diversify their products. Experience has shown that growth in a single niche slows over time especially where more market players try to have a piece of the same bread. Therefore, the existing leasing companies should pay more attention for product diversification and expansion of their base and business segments. Since the market segment is approaching more specialization they should keep themselves more focused on that. There was a time in mid eighties when leasing was a new product and the customers were fragmented and not well informed. It was then possible for a leasing company to edge out higher margin with more favorable terms and conditions. But with the passage of time competition is getting tougher with more and more companies coming in. Higher professional skill and better technological support have become the hall mark to chase opportunities. The only way to survive is to specialize. It is reported that the "G E capital of the United States have over 20 separate businesses". But the fact remains that leasing industry cannot survive without active support and patronage from the Government with its four pillars of financial edifice. These are "the legal, the direct tax, the financial accounting and the regulatory pillars. Nuances within each of these four pillars particularly legal, direct tax and regulatory can either positively or adversely impact the industry with respect to volume, growth and market penetration," asserts Mr. Sudhir P. Arambel, the international guru of leasing.

The importance of the BLFCA

In this age of regional, inter-regional or intra-regional convergence no society or group nor any country can live in isolation. There is, therefore, a surge even among nations to unite and voice their agenda. The formation of different regional groups or blocks are instances that driving the nations to large unity among themselves. In the business area, the formation of different chamber bodies are also aimed at bringing them nearer to each other and resolving their problems. The formation of the Bangladesh Leasing and Finance Companies Association (BLFCA) is an attempt towards that direction to unite the NBFI under a common platform and voice and ventilate their grievances to relevant authorities on the one hand, and forge better understanding and unity among the fellow members on the other. An industry or a group needs an organization to help the individual members to do what they cannot do alone. That is the basis of social or business organizations including those of the Governments. Thus the importance of an apex organization for the NBFI in Bangladesh such as the BLFCA can hardly be over emphasized. It is expected that the BLFCA will play a constructive and unifying role in fostering better understanding as much with the different regulatory bodies as with their fellow members within the country and outside.

The author Mr. A. Quadir Choudhury is the Managing Director of Phoenix Leasing Company Ltd. & Vice Chairman, Bangladesh Leasing & Finance Companies Association.



A. Quadir Choudhury

BLFCA