ANALYSIS OF PROBLEMS AND PROSPECTS
OF
LEASING BUSINESS IN NEPAL

A THESIS

SUBMITTED BY

SHARADA LAMSAL

SHANKAR DEV CAMPUS

(T.U. REGD. NO.: 7-2-39-296-2002)

Roll No. 463

SUBMITTED TO

OFFICE OF THE DEAN

FACULTY OF MANAGEMENT

TRIBHUVAN UNIVERSITY

IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE

OF

MASTER'S OF BUSINESS STUDIES MBS

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RECOMMENDATION

This is to certify that the thesis

Submitted By

Sharada Lamsal

Entitled

ANALYSIS OF PROBLEMS AND PROSPECTS OF LEASING BUSINESS IN NEPAL

has been prepared as approved by this Department in the prescribed Format of Faculty of Management. This thesis is forwarded for examination.

………………………………

……………………………..

Kishor Maharjan Kamal Das Manandhar

(Thesis Supervisor) (Campus Chief)

VIVA - VOCE SHEET

We have conducted the viva-voce examination of the thesis presented

by

Sharada Lamsal

Entitled of

ANALYSIS OF PROBLEMS AND PROSPECTS OF LEASING BUSINESS IN NEPAL

and found the thesis to be the original work of the student written according to he prescribed format. We recommend this thesis to be accepted as partial fulfillment of the requirements for Master of Business Studies (MBS)

VIVA - VOCE COMMITTEE

HEAD OF RESEARCH DEPARTMENT

Member (Thesis Supervisor)

Member (External Expert)

Date…………………………..

DECLARATION

I here by declare that the data and work reported in this thesis entitled **"ANALYSIS OF PROBLEMS AND PROSPECTS OF LEASING BUSINESIN NEPAL"** submitted to the Office of the Dean, Faculty of Management, Tribhuvan University of the requirement of the degree of Master of Business Studies (MBS), Under the guidance and supervision of Mr. Kishor Maharjan of Shanker Dev Campus, Tribhuvan University.

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LIST OF ABBREVIATION

AS	Accounting Standard
FAS	Financial Accounting Standard
IAS	Accounting Standard
PV	Present Value
CFAT	Cash Flow After Tax
NRB	Nepal Rastra Bank
NSLMB	Nepal Shri Lanka Merchant Bank Limited
UFCO	Union Finance Company
ILFC	International leasing and Finance Company
NAL	Net Advantage to Lease
IRB	Internal Rate of Return
PVIFA	Present Value of After Tax Outflow.

CHAPTER 1

Introduction

1.1 General Background

The reason behind Nepal's underdeveloped economy is not due to lack of resources but it is due to not proper utilization of the available resources in efficient manner. For proper and efficient utilization of resources it needs proper plan and strategy development and for plan and strategy development huge amount of capital investment is required.

The Democratic Republic of Nepal is a small land-locked country in south Asia with agro based economy. The country is divided into mountains, hills and terai with its geographical nature. Economic status of our country is growing very slowly and Nepal is known as very poor country all over the world. More than 70 percent of the people are still in rural areas and most of them are not getting even minimum physical facilities that are necessary for human beings because of underdevelopment of these areas and their poverty. Its economy is dependent on traditional agriculture. The agriculture plays dominant role in the Nepalese economic is well established.

With globalization, the world is presently becoming more integrated. Globalization gives nation the opportunity to increase their productive efficiency, service efficiency and other function also to attain their comparative advantage.

Development of different institutions is essential for the rapid economic development of the country. Although, being an agriculture dependent country the non-agriculture sectors should be given priority. This will help not only to solve the problem of employment but also in the economic development of the nation. However, agriculture alone is not sufficient for the development of the nation. Industrialization is an important factor for the swift development of the country. Only the establishment of the industry is not sufficient but successful operation is also necessary. For successful operation every industry and organization needs finance. This success and failure of business and industry widely depends on the crucial decisions made by the top management relating to the top management of fund. Capital structure decision is one of the most crucial complex areas of financial decision making area relating to the management of the fund due to its interrelationship with other financial decision variables.

Each and every managerial decision-making is based on financial analysis. It covers the acquisition, utilization, control and administration of funds. “Managerial finance is an existing and dynamic area of study and its importance to the long run success of today’s business is unquestioned.”[1]
Finance is the important prerequisite for establishing and developing any business organization. Finance helps bringing together all the factors of production in industrial unit. Therefore finance is a crucial element for success of business. In the absence of adequate finance even the business having high potentiality may fail. Financial decisions impact on the long-

[1] Lawrence J Gittman,” Principles of Managerial finance” 4th edition; Harper and Raw Inc, New York (1985)

range financial strategies of the firm there by putting effect on the value of the firm.

Among several systems, financial system is very important. This financial system of the country is related with the entire system operating in relation with the fund flow. The fund flow can be inflow and outflow of the fund. Financial system is the core organ for the development of the national economy. The financial system is changing rapidly and that change is driven by the innovation. So this cannot be defined precisely.

Several institutions are involved in financial system, which assists the smooth operation of different system. One of the major components of this system is financial market. Financial market is just like any other market where instead of goods and services financial instruments are traded. People gather to buy, lease and sale financial investments. For any development in the country, a country should have adequate number of competent financial institutions like banks, finance companies, cooperative society and leasing companies providing better services in the needed area. To the greater extent the growth of economic development is based on the services provided by the above financial institutions.

1.2 Historical Background of Financial Institutions in Nepal

Nepal has crossed the several stages to reach the present stage of economy in financial system.

The first stage of financial system is the era during which the commodity money such as gold, silver, coins generally accepted as a means of payment. The coinage in Nepal is generally assumed to have begun from the 5th century AD. The denomination is not known, as they bear no inscription on them.

The introduction of coins in Nepalese financial system facilitated the transaction of surplus to the deficit sectors. During the 12th century silver coinage came into existence in Nepal. This widened the scope for trade among the people living in different societies or groups.

The concept of debt was started during the second stage, it means after 12th century. During this stage the interest bearing private debt such as bonds, mortgages and loans came into existence even in those days to meet the future contingencies of deficit group of people. They started to borrow from surplus group. We come across the term "debt" in Nepal during the year 879/80 AD. It is recorded in the Nepalese chronicle that "Shankhadhar" (a low caste merchant) introducing in AD 879/80, the new era after having paid off all the "debts" then existing in the country.

In fact, the "Thanka Dhari" means money holder. In those days they use to deal on money. Therefore, the term "Thanka Dhari" has been defined to represent the money dealer. They were found in existence at the end of the 14th centuries. We can conclude that money changing was adopted as a profession by a section of the people in Nepal that time. According to the adopted profession, this became a caste.

Landlords, shahukars, shopkeers and others used to lend the money. So these people are considered as hindrance for the development of financial system. But the concept of lending and borrowing initiated. A brick was added in the system.

The "Tegarath Adda"

Prior to the establishment of Nepal Bank Ltd. there was no organized financial institution of Nepal. Then the Nepalese people are heavily dependent on agriculture sector. Even for the cultivation and other activities if they were in need of money they had to rely on personal borrowings. In this situation, the lenders charged heavy amount of interest. The money lenders capitalized the interest in case of borrowers default in paying interest. Most of the borrowers had to loose their property i.e. land, houses etc. due to the failure in making payment.

"Tegarath Adda" was established during the primeministership of Ranoddip singh 1877 AD. It was established with the 100 Percent subscription of government in Kathmandu valley. The basic objective of this "Adda" was to provide credit on the general public at cheaper rate i.e. 5 percent. The "Adda" disbursed credit on the collateral of gold and silver. During the primeministership of Chandra Shamsher "Tegarath Adda" extended its services by opening branches in some cities outside valley. So it could be regarded as the primer foundation of modern banking. (Forty years of NRB- published by NRB)

Some used to say that the "Kaushi Tosha Khana" established during the regime of Prithivi Narayan Shah was the foundation of modern banking. . (Forty years of NRB- published by NRB)

The development of modern financial system can be traced back to the establishment of Biratnagar Juit Mills ltd. It was the first joint stock company of Nepal established in 1937AD. Though the company was established to protect the financial interest of the dependent of Rana family, initiated the concept in the country. This company was established as a joint stock company in collaboration with Indians. After the incorporation of the above said company, the Nepal Bank Ltd was established in the country. Actually this bank took over all the activities of “Tegarath Adda” and extended its services to the people. Several other companies were established during the period of Second World War. The industries were located around terai region but those companies can not survive long.

The political system was changed in BS 2007. The democratic system was introduced. But six year was spent to store the democracy. The first five year plan was lunched in BS 2013. The stage of modern financial system can be studied on the basis of plan period but it will be better to deal from 2013 to 2045 and after the restoration of democracy to till now.

The first five- year plan emphasized the development of agriculture sector and also emphasizes to create the basic infrastructure development for industrial development. But six year was spent to store the democracy. The first five year plan 1956 to 1961 AD (i.e. 2013 to 2018) was brought out. During this plan period Nepal Rastra Bank, the central bank was incorporated in 1956 AD under the Nepal Rastra Bank Act, 1955AD. The major objective of this bank was to work as a banker to the His Majesty’s government and to eliminate dual currency system in the country. Besides it also target to develop other financial infrastructure for the development of the country.

The formal industrial Development Bank established on 1957 AD was converted into Nepal Industrial Development Corporation in 1959 AD. The basic objective of the corporation of the bank was to work as a development bank and to make equity as well as debt financing in the country.

The first issuance of government bond took place in 1963 to mobilize the public savings and to use this amount for development activities. This was regarded as the cornerstone for the modern Nepalese financial system. Presently, public Debt Act was managed by a separate public Debt Department under the public Debt Act. This department of NRB is responsible to issue short-term as well as long-term instruments.

Agriculture Development Bank was established in 1968 AD to finance the agriculture activities and agro based industry. Later on the bank started to do the banking activities to mobilize the public savings. The contribution of the bank outside the valley is significant.

National Insurance Company was established in 1966 AD. This was the first insurance company established by the government. This company cultivates the habits of insuring among the general public and Nepalese entrepreneurs. This insurance company was executing both life and non-life insurance policy in the country. Later on the share of non-life insurance was sold to the general public under the principal of privatization.

Employees' provident fund was established in 1962 AD with an objective of providing security to the government employee after their retirement. Presently, more than 400000 employees are participating in the fund.

Another significant step taken by the government for the development of financial market was the establishment of Securities Exchange Center in 1976 AD (i.e. 2033 BS). The major objective of the center is to carry out the primary and secondary market for corporate and government securities. But due to the lack of governing act it had limited its activities only on trading of government securities. It was operating both the primary and secondary market for the government securities. It was managing public issue, underwriting the shares, brokering on ad hoc basis. Securities Exchange Act, 1983 was enacted on 1984. After the enactment of the act it listed the shares of seven companies and started secondary market.

BS 2046 onwards

The Securities Exchange Center before converting into Nepal Stock Exchange managed 26 public issue of 25 companies. The former Securities Exchange Center was converted into Nepal Stock Exchange after the first amendment in securities Exchange Act, 1983. The act envisaged the specialization. So under the act Securities and Exchange Board and Nepal Stock Exchange were established as the secondary market for corporate and government securities. It licensed to function as the manager to the issue as well as member broker and market maker to perform the role of market intermediaries. Later on the classification of the member is also widened as member broker, market maker and dealer primary market and secondary market.

Several banks and other financial institutions are also established in the system. According to the data published by Nepal Rastra Bank in Banking and Financial Statistics mid January 2006 - Starting from 1990s, finance companies have been growing rapidly. The total number of finance company that stood at 47 in mid July 2000 reached to 63 in mid January 2006. However, majority of the finance companies are rendering their services in Kathmandu valley, of the total finance companies, 62 are being operated in central region, and the rest are being operated outside the region.

Some of the joint venture banks have extended their regular service to ATM service, credit card and others. All these institutions canalize the funds from non-productive sectors to productive sectors.

1.2.1 Financial sector at a glance

The Nepalese financial sector is composed of banking sector and non banking sector. Banking sector comprises Nepal Rastra Bank (NRB) and commercial banks.

The total number of Finance companies increased to 60 as at mid-July 2005 from 59 some years ago. In today numbers of financial institutions have been established. Increased in financial institutions has definitely enlarged the choice of the customers, expanded lending activities and raised competitions among the financial institutions. At the mid January 2009, the total no. of finance companies increases from 72 to 78. (The details of list of finance company is in Appendix-1)

1.2.2 Distribution of financial institutions

Distribution of financial institutions (Development Region wise)

Table no.1

Development Region	Eastern	Central	Western	Mid-Western	Far-Western	Total
No. of Finance Companies	4	62	10	1	1	78

Source: NRB, Micro Economics Indicators of Nepal July 2008.

1.3 Concept of Leasing

Leasing is a source of intermediate and long term financing. Leasing is a method of acquiring the right to use the assets for a specified period of time without obtaining an ownership or title. A lease is a contract between the owner of the assets (the lessor) and the user of the assets (the lessee). Under the contract the lessor grants the lessee the right to use the assets for an agreed period of time. In return, the lessee agrees to make a series of periodic payments (or lease rent) to the lessor. Leasing involves the use of an asset without the desire to assume or intend to assume ownership. A firm acquiring an asset is called the lessor. The lessor gets a money rental at regular intervals for its use from the lessee. It is not essential to purchase asset in order to use them. Asset may be rented. Rentals can be based on some periodical basis. The provision for the use of major assets is covered in a leasing contract. The contract includes the lease period, cancellation provisions, rental payments, additional rents or purchase options, allocation of maintenance and other features of the agreement. In the leasing procedure a property is leased by its owner. Ownership is retained with the lessor. A clear understanding of the role to be played by the acquisition is an essential prerequisite.

1.3.1 Leasing Business in Nepal

Without proper and timely reformation, financial sector cannot take full speed on its development process, Nepal has adopted open, liberal and market oriented economic policy since late 1980's and simultaneously financial sector reform programs have been initiated. But with the passage of time, financial sector is becoming more exciting, challenging and ever-changing sector due to increased economic liberalization and globalization.
To cope with such complex situation, financial innovation should be given priority so that sophisticated financial market, improved financial instruments as well as efficient and effective financial process can be developed. Presently there is proliferation of various banking and non banking financial institutions in the country offering wide range of services including much new type of financial services like venture capital, leasing, merchant banking, mutual fund etc.

Among such new financial services leasing is one of the innovative financial services which carry extremely different philosophical idea about the use of capital assets in productive activities. Leasing concept advocates that the important thing is the service we get from using assets, not the ownership on it. Therefore, it is wise to take service of any asset on rental basis without purchasing it. After the World War II, leasing has achieved significant growth in a global perspective. In Nepal also, it has been started, but people have not been well informed about this financial service. There are number of ambiguities about it. Its real financial meaning has not yet been realized in Nepalese financial community.

Major thing of lease deals executed in Nepal have been in the area of vehicles, plants and machinery. In case of most of the plant and machinery and light vehicles depreciation rate prescribed for tax purpose is 20% of diminishing balance method. And the heavy equipment like industrial machineries can be depreciated at the rate of 25%. Generally lease rentals fixed by leasing companies are flat rentals, i.e. equal rental over the term of lease. In case of flat rentals residue left after recovery of the finance income, the capital recovery takes a back heavy pattern.

1.4 Statement of the Problem

There are various problems regarding the leasing business. The problem is not the one sided but both the lessor and lessee has to face problems. In Nepal, except familiarization with the term lease traditionally used for real estate leasing. It is quite new for financial companies of Nepal. Few financial companies have taken initiatives to introduce the leasing business in Nepal. There is also a great scarce of literature regarding leasing business in the context of Nepal. It has been overlooked subject in the matter of finance. Even the academic society is not well acquainting with the leasing. From the discussion held with related officials of Nepal Rastra Bank (NRB), it is known that it has not been well discussed and the micro and macro economic impact of leasing has not yet been addressed. Likewise, companies operating leasing business reported that leasing in

Nepal is as like as just born baby who is familiar to his family members only. Therefore they are trying to introduce the leasing business in Nepal despite such extremely unfavorable circumstances. This situation of Nepalese leasing business has created serious need to conduct research which can explore and highlight the real picture of leasing business in Nepal. Therefore this research is being motivated and directed towards the following research problem:

How the leasing is being practicing in Nepal?

- How finance companies are viewing to the matters relating to the leasing business in Nepal?
- Both parties faced the problem of the clauses embedded in the lease contract that sometime may not be agreed by the lessee.
- Lessor usually would like to sign for the net lease but the lease would not like to take the burden of maintenance and may opt for the maintenance lease contract where the lessor maintains the property through out the lease period and bears all the cost of such maintenance. For this reason maintenance lease rent can be higher than that of net lease, which is usually opposed by the lessee.
- The relation between the lessor and the lessee is not very sound. The problem is they both don't act like business partner rather they act like debtor and creditor or in other words they act like debtors and creditors who has gone bad. This may be due to low professionalism between them and current economic situation of Nepal which may have left both the parties to argue due late payment of rent or due to low or null maintenance by the due parties. Low economic conditions have led to less effective use of the asset and thus making the lease difficult to cope up with limited

finance generated by the asset. This indirectly affects the lessor too by not getting his payment in time.

1.5 Objective of the study

The main objectives of the study are to find out the specific problems and prospects related to the leasing business in some finance companies which are doing leasing business in Nepal. To attain the main objective, following other specific objectives have been set up.

To study and analyze the introduction growth and development of leasing business in finance companies.

To study the clauses of the lease contract.

To study and examine the practices and procedures followed and course of performing leasing business in Nepal.

To analyze problems, challenges and prospects of leasing business in Nepal.

1.6 Significance of the study

The present study deserves some significance of its own kind in this field. This study will be concise, practical, usable and valuable to the major parties interested in the leasing business. The study will also useful for teacher and students of the subject particularly those in commerce related capital structure and institutional finance.

In the context of Nepal there is less availability of research work, journal and articles in leasing business of finance companies as well as other banking sectors. There are few researches in leasing business so this study will try to find the problems related with the leasing business in Nepal. It will also try to find the solutions for the problems found. This study will try to show the scenario of current leasing business situation in Nepal. And I believe this will helpful in some or the other way the concerned person or the organization. Since, many people are unaware of benefits of leasing business; it will also be helpful for them to choose for the better alternative between loan and lease. And the promising result of this research also may help to encourage the other business house to invest more leasing business in coming future.

The other significances of the study are:-

It will portray the picture of leasing business. Therefore it will hold practical value to concerned institutions policy makers and regulatory body.

It will also helpful for those who are searching for new alternative of financing their capital asset.

It will enhance awareness about leasing business of Nepal. It will fulfill the research gap in the leasing business sector of Nepal.

1.7 Limitations of the study

The study has the following limitations.

The study has been covered only those finance companies, which have been located in Kathmandu due to travel constraint.

It is focused mainly from the finance companies point of view.

The accuracy of the information is the main ingredient for the success of this research.

1.8 Organization of the study

The whole study is organized into five chapters in the following order.

Chapter 1:- Introduction

The introduction chapter includes the general background, historical background of financial institutions in Nepal, objective of the finance company, rules and regulation of finance company, concept of leasing, leasing business in Nepal, statement of the problem, objectives of the study, significance of the study and limitation of the study.

Chapter 2:- Review of literature

The second chapter deals with review of literature. It consists the theoretical review of studies and review of related previous studies.

Chapter 3:- Research methodology

The third chapter describes methodologies employed to attain the objectives of the study.

Chapter 4:-Data presentation and analysis.

The fourth chapter deals with the analysis and presentation of data collected during the whole survey period and its major findings. It consists descriptive as well as statistical analysis of data or information.

Chapter 5:- Summary, conclusion and recommendation.

The last chapter contains the summary, conclusion and recommendation of the study. The summary conclusion and recommendation is the final segment of the study.

The bibliography and appendices is also included beside the above chapter.

CHAPTER- 2

REVIEW OF LITERATURE

Review of literature

This chapter has been especially designed to achieve two different objectives. One is acquire the strong background knowledge of leasing business and meaning of various terms of the lease. And this chapter attempts to review the journals, research papers and thesis dissertations made on a particular field of study. The review of literature is important to know what is available and the gaps that exist in the literature.

For this purpose, this chapter has been divided into following two parts.

Review of conceptual framework

Review of previous related studies.

2.1 Review of Conceptual Framework

This chapter contains some details about the various conceptual aspects of leasing. So, under this chapter various aspects of leasing business have been studied like meaning and definition of leasing, basic elements of leasing, types of leasing, accounting for leases, types of assets that can be leased, advantage of leasing, tax consideration in leasing, limitation of leasing, financing aspects of leasing business etc. The above mentioned topics explained in the following part will greatly help to analysis the problems and prospects of leasing business in Nepal.

2.1.1 Meaning of lease or introduction of lease

Leasing is a source of intermediate and long term financing. It is also a method of acquiring the right to use the assets for a specified period of time without obtaining an ownership or title.

A lease is a contract or an agreement in which one party (the owner of an assets or lessor) conveys to another party (the user or the lessee) the exclusive right to use the asset in exchange for a sense of payment (the lease rent) for a specific period of time. It, therefore embraces an interest rate return to the lessor. Most of us are familiar with leases of houses, land, apartments, offices or telephones. Leasing has been an important part in business sector in recent decades like leasing of business assets such as land of building, computer and other heavy equipments cars and trucks (vehicles), machinery manufacturing plants etc. This has been growing business for owner of the certain asset at most of the new business firm do not possess enough capital own an asset or rather they find it beneficial to lease than to purchase so the business firms usually leases the assets and uses it in their business without having to buy it. For this advantage, the lease incurs several obligations. First and foremost is the obligation to make periodic lease payments, usually monthly or quarterly and in advance. Also the lease contract specifies who is to maintain the asset. Under a maintenance lease the lessor pays for maintenance, repairs, taxes and insurance. Under a net lease, the lease pays these costs.

2.1.2 Basic Elements of Lease

These essential elements of leasing are the following.

2.1.3 Parties involved to the lease contract

A contract can not exist without two or more parties. And in the lease contract there are essentially two parties. They are the owner of the asset and the user of the asset respectively called the lessor and the lessee.

Lessor: - Lessor is the owner of the assets and holds the title to them.

2.Lessee: - Lessee is the firms using the assets and takes physical possession of the assets. The lessee pays the fixed payment (called lease rent /rate) to the lessor over the lease period.

Lessor as well as lessee may be individual, partnerships, joint stock companies and corporations or financial institutions. This does not necessarily means that both the parties should be of same kind, they might differ. Like, the lessor being and individual and lessee an organization. Sometimes there may be joint lessor and joint lessee particularly where the properties or the amount of finance involved is enormous.

There are also parties known as lease broker, who acts as intermediately in arranging leases deals. They charge certain percentage of lease amount as fee for their professional help or service lender is the third party involved only in leveraged leasing. It is also called the financer, who refinances the lessor either by providing term loan or by subscribing to equity under a specific refinance scheme.

In this study of lease's analysis of problems and its prospects the author has taken the lessor (Finance companies) and lessee (individual / organization etc).

2.1.4 Types of Assets that can be leased

A lease contract is made for the asset. Therefore, without any type of assets, a lease contract may not exist, as the asset, property or equipment to be leased is the subject matter of a lease contract. A firm can lease almost any kind of asset needed to conduct its business. Firms lease land, building and even factories with all their equipments. Manufacturers with a desire to make sales to customers that are short of cash encourage leasing and may even help a customer make arrangements to lease. (Hampton; 1994:486.)

Normally two types of assets are preferred for leasing. One is the asset having high cost like automobiles plant and machinery, land and building, aero plane, ships, heavy equipments, machinery, vehicles and so on. And another is the asset in which technology changes rapidly such as computer, television, medical equipments different types of vehicle etc.

2.1.5 Ownership separated form user

The essence of lease financing contract is that during the lease tenure ownership of the asset remains with the lessor. However the ownership may be transferred at the end of the lease term if stated so in the contract. May be, sold as scrap, and any incoming amount (usually cash) will be treated as income.

2.1.6 Lease Rental

The consideration, which the lessee pays to the lessor for the lease transaction, is the lease rental. The lease rentals are so structured as to compensate the lessor for the investment made in the asset, the interest on the investment, repairs, insurance if any brone by the lessor and servicing charge over the lease period.

2.1.7.Term of lease

The term of lease is the period for which the agreements of lease remain operation. Every lease should have a definite period, otherwise it will be legally inoperative and the lease period sometimes may stretch over the entire economic life of the asset (i.e. finance lease) or a period shorter than the useful life of the asset (i. e operating lease), the lease may be perpetual that is with an option at the end of lease period to renew the lease for a further specific period.

2.1.8. Modes of termination of lease

At the end of the lease period the lease is terminated and there are various ways possible for this purpose.

The lease is renewed on a perpetual basis or for a definite period, or

The asset reverts to the lessor, or

The asset reverts to the lessor and the lessor sells it to a third party, or

The lessor sells the asset to the lessee.

The parties may mutually agree to and choose any of the aforesaid alternatives at the beginning of the lease contract. (Khan and Jain, 1999: 9.1-9.2)

2.2 Types of lease

Leases take several different forms, which are depending upon the terms and conditions agreed by the lessee and lessor. The most important types are as follows:-

Sale and lease back.

Service or operating leases.

Straight financial leases.

Direct lease

Leveraged lease.

Sale and lease back

Under a sale and lease back agreement, a firm sells an asset for cash to another party (a prospective lessor) and this party leases it back to the firm. The lessor is usually a finance institute such as commercial bank. A sale and lease back agreement is normally utilized by a firm that is suffering from the shortage of funds for its operations or is faced with liquidity crisis. As lessee receives cash that is received from sale of asset it can solve the asset for agreed period.

Direct lease

Under a direct lease, the lessee identifies the asset it requires and either leases it directly from the manufacturer or else arranges for a leasing company (or finance commercial bank) to buy it form the manufacturer and then enters into a financial lease contract with the lessor. (Finnerty, 1989: 374)

In other word, under direct leasing lessee did not previously own the assets. The lessor may be manufactures, finance companies, banks etc.

Leveraged lease

A leveraged lease is special arrangement under which the lessor borrows a substantial portion of the acquisition cost of the leased assets form a third party. In contrast to two parties involves leasing, three parties are involved in leverage leasing; (i) lessee, (ii) the lessor; and (iii) the lender. Leveraged lease is a popular method of finance for expensive assets such as aero plane, ship etc. The third party (i.e. lender) involved in financing the transaction is usually a finance institute like insurance company, commercial banks. Leveraged leases are complicated from the standpoint of both lender and lessor but they remain a financial lease from the standpoint of the lessee.

Operating leases/service leases

It is contractual agreement where by the lessee acquires the use of an asset on a period to period basis. In other words, operating lease contracts are for short period and are cancelable at the option of the lessee. A lease under which the lessor maintains and finance the property; also called a service lease' or, maintenance lease'. Lessee prefers operating lease for the asset in which technology changes rapidly. Generally operating lease appears in footnote of balance-sheet, following are the key characteristics of operating lease.

Operating lease contracts have short period.

Operating leases are not fully amortized. It means that rental payments required under the lease contract are not sufficient for the lessor to recover the full cost of the asset. The lessor expects to recover all cost either by subsequent renewal payments, by re-leasing the asset to other lessees, or by selling the asset.

Cancelable by the lessee prior to its expiration.

Risk of obsolescence is shifted to lessor.

Financial or Capital Lease

A lease that does not provide for maintenance services, is not cancelable, and fully amortized over its life; also called capital lease . Financial lease are commonly used for leasing land, building, ships plants and high price fixed assets. Financial lease is basically the same kind of alternative as long term debt financing as per the point of the view source of financing. Financial lease holds following characteristics.

The lease is non-cancelable.

The lease is fully amortized.

The lessor does not provide for any maintenance services.

Financial lease contacts have long period.

The typically arrangement involves the following steps.

The firm that will use the equipment selects the specific items it requires and negotiates the prices and delivery terms with the manufacturer or distributor.

Next, the user firm arranges with a bank or leasing company for the latter to buy the equipment form the manufacturer or distributor. Simultaneously executing an agreement to lease the equipment form the financial institution. The terms call for full amortization of the financial institution's cost plus a return on the lessor's investment. The lessee generally has the option to renew the lease at a reduce rental on expiration of the basic lease but does not have the right to cancel the basic lease without completely paying of the financial institution. (Weston and Copeland 1992 996-997)

2.1.4 Accounting for leases

Where once leases where not disclosed and were attractive to some as "Of balance sheet" financing, this no longer is the case. Financial standards Board Statement No. 13 requires capitalization on balance sheet of certain types of leases. In essence, this statement says that if the acquires essentially all of the economic benefits and risks of the leased property, than the value of these asset along with the corresponding lease liability must be shown on the balance sheet.

2.1.4.1 Capital and Operating Leases

Leases that conform in principle to this definition are called capital leases. More specifically, a lease is regard as a capital lease if it meets any one of the following conditions.

The lease transfers title to the asset to the lessee by the end of the lease period.

The lease contains an option to purchase the asset at a bargain price.

The lease period is equal, to or greater than, 75 percent of the estimated economic life of the asset.

At the beginning of the lease, the present value of the minimum lease payments equals or exceeds 90 percent of the fair value of the lease property to the lessor.

If any of these conditions is meeting, the lease is said to have acquired most of the economic benefits and risks associated with the leased property; therefore, a capital lease is involved. If a lease does not meet any of these conditions, it is classified as an operating lease. Essentially, operating leases give the lessee the right to use the leased property over a period of time, but they do not give the lessee all the benefits and risks associated with the asset.

2.1.4.2 Recording the Value of Capital Lease

With a capital lease, the lessee must report the value of the leased property on the asset side of the balance sheet. The amount reflected is the present value of the minimum lease payments over the lease period. If executory costs, such as insurance, maintenance and taxes, are a part of the total lease payment, these are deducted and only the remainder is used for purposes of calculating the present value. As required by the accounting rules the discount rate employed is the lower of (1) the lessee's incremental borrowing rate or (2) the lessor's implicit interest rate if, in fact, that rate can be determined.

The present value of the lease payments should be recorded as an asset on the lessee's balance sheet. (If the fair value of the leased property is lower than the present value of the minimum lease payments, then the fair value would be shown.) The associated lease obligation would be shown on the liability side of the balance sheet, with the present value of payments due within 1 year being reflected as current liabilities and the present value of payments due after 1 year being shown as non-current liabilities. The lease property may be combined with similar information on assets that are owned, but there must be disclosure in a footnote with respect to the value of the leased property and its amortization.

2.1.4.3 Disclosure of Operating Leases

For operating leases, as for capital leases, some of the same disclosure is required but it can be in footnotes. For non-cancelable lease having remaining terms in excess of 1 year, the lessee must disclose total future minimum lease payments, a schedule by year for next 5 years, the total sublease rentals to be received, the basis for contingent rental payments, the existence and terms of purchase and renewal options and escalation clauses, and any lease agreement restrictions. The last two categories are included in a general description of the leasing agreement.

2.1.4.4. Amorting the capital lease and reducing the obligation

A capital lease must be amortized and the liability reduced over the lease period. The method of amortization can be the lessee's usual depreciation method for assets that are owned. It should be pointed out that the period of amortization is always the lease term, even if the economic life of the asset is longer. If the latter occurs the asset would have an expected residual value, which would go to the lessor. It is also required that the capital lease obligation be reduced over the lease period by the "interest" method. Under this method, each lease payments are separated into two components: the payment of principal and the payment of interest. The obligation is reduced by the amount of the principal payment.

2.1.4.5 Reporting Earnings

For income reporting purposes, it is required that both the amortization of the leased property and the annual interest embodied in the lease payment be treated as an expense. This expense then is deducted in the same way that any expense is, to obtain net income. This treatment differs from that for the operating lease, for which only the lease payment itself is deductible as an expense.

2.1.5 Advantages of Leasing

This is the age of science and technology. Everything is changing rapidly day by day. In another word, banking sector or finance sector is going competitively. The success of any business organization depends upon the level of need satisfying capacity of the offered product or service.

There is different between the cost of lease and the cost of buy. Lessee and lessor both can take advantage form the leasing business. Here are some advantages of leasing to the lessee.

Leasing is a method of financing is less costly rather than other alternative.

Lease payment is tax-deductible expenditure.

It helps to avoid huge initial investment.

Assets can be obtained within very short period under lease financing.

Leasing helps to shift the risk of obsolescence to lessor.

Borrowing power can be retained by using lease financing.

Lower repairs and maintenance cost is occurred because lessor may have expert technicians which help to reduce per unit maintenance cost.

By leasing the assets, the lessor may be able to avoid some of the restriction that exists on debt financing i.e. compulsion to inform to take loan from others, restriction to pay dividend.

Advantages of lease to the lessor

Lessor can enjoy benefits of depreciation tax shield and investment tax shield.

Recovery of money is speedier in case the borrower goes bankrupt.

The lessor has a stronger legal right to take back assets if lessee does not meet his obligations.

2.1.6. Tax consideration in leasing

Tax plays a very important role in structure of lease and in the value of lease to both the lessor and the lessee. (Rao, 1992: 801)

The treatment of capital leases for tax purposes differs from that for income statement purchases. For tax purposes, most companies report the lease payment as an expanse. In other words, for tax purpose, a company does not deduct the amortization of the asset and the interest s the expense of a capital lease. It deducts the annual lease payment.

Considering the impact of leasing in a macro economic prospective government or governmental agencies issue certain guidelines regarding leasing. These guidelines are very important for the deal of leasing. These guidelines issued by internal revenue service (IRS) are important to consider.

the most important is that the lessor have a minimum "at risk" investment, both at inception and throughout the lease period of 20 percent or more of the acquisition cost of the asset. This means a residual value of at least 20 percent of initial cost.

The remaining life of the asset at the end of the lease period must be the longer of 1 year or 20 percent of the lease asset's original estimated life.

There must be an expected profit to the lessor from the lease contract, apart from any tax benefits.

In essence, the lese contract is not, in effect, a purchase of the asset, for which payments are much more rapid than would be allowed with depreciation. As lease payments are deductible for tax purposes, such a contract would allow the lessor to effectively depreciate the asset more quickly than allowed under a straight purchase. If the lease contract meets the conditions described, the full lease payment is deductible for tax purposes.

2.1.7 Limitation of Leasing

Most of the growth of leasing was due to the fact that it was an off balance sheet method of financing. Critics of leasing have strongly argued that leasing is only a disguised form of debt financing. Donald Gant says. "Lease financing is then essentially a form of borrowing – perhaps borrowing an asset rather than the funds with which to purchase it, but resulting in obligation which are substantially the same as those incurred in debt financing." "He further advances his argument by saying that after all, we have seen that lease financing results in an assumption of capital risk on the part of the company and with it an objection similar to that imposed by debt, it would seem, then, that whether the company uses its credit in the firm of direct borrowing or to support lese commitments the total amount of its obligations will be the same. There is evidence to believe that leasing is regarded by the business community only as another form of debt. In a survey carried by Vancil and Anthony in USA in 1959 indicated that maximum respondents regard leasing as an intermediate form between secured debt and unsecured debt. Further, off balance sheet in so far as the balance sheet is placed before a financial analyst has no relevance, as accounting rules in most of the countries require disclosure of lease in lessee's balance sheet.

In most of the cases, leasing may be costlier than a straight borrowing because the lessor is only a financial intermediary and himself borrows from the market at the prevailing or higher borrowing rates to which he adds his own profit also.

When rate of depreciation is quite high, taking assets on a lease may results in loss of ax benefits particularly when the asset is being acquired towards the year-ends. Had the company bought the asset rather than leased in it, it would have claimed a full years depreciation under tax laws.

As, at the termination of lease period, the asset reverts to the owner the lessee loses his claims on the residual value. At times, the equipments may have much higher residual value than what was provided at the inception of lease, so that lessee loses a substantial ownership benefit. The sale of residual is sometimes protection against inflationary erosion of money value.

Leasing does not provide the lessee the pride of ownership. Many people would not be satisfied merely by the right to use which is provided under lease. They psychologically crave for ownership.

The lessor himself finances the lease by funds borrowed from banks and financial institutions and the leased asset is hypothecated to the banks. In case the lessor fails to meet his obligation to banks, banks shall seize the asset, causing loss to the lessee.

Leasing as a mode of finance is limited to equipment needs only. It cannot help a company secure working capital.

An environment of uncertainty prevails in the leasing industry, which is still at fledging state (Kothai, 1991:26-28)

2.1.8. Sources of value in leasing

There are different factors that give rise to leasing's being a thing of value in the capital market. Differing tax rates between the lessor and lessee are the main source of value in leasing.

Lease financing in perfect capital market:-

If the capital market are perfect, there are no transaction costs, information is costless and readily available to all securities are infinitely divisible, there are no bankruptcy costs, and there are no taxes. Under such condition the debt and lease obligations of a firm will be valued by secured lenders and lessors in the same manner. The costs of debt and lese financing will therefore be the same, and the firm would be indifferent between the two as methods of financing.

In the perfect and complete capital markets, debt and lease instruments may not be valued in the same manner. The imperfection of transaction costs, information costs, and less than infinite divisibility of securities do not have a systematic effect in the sense that they favor lease or debt financing all of the time. Rather, arbitrage between the markets is impeded; consequently, it may be possible for the firm to take "advantage" of the situation by issuing one type of instrument or the other. Because the advantage is likely to be small and difficult predict in practice.

Bankruptcy costs to the lender or lessor:-

If a lease or borrower liquidates, the lessor's position is some what superior to that of a supplier of capital. The lessor owns the asset and can retrieve it when the lease defaults. The lender finds it more difficult and costly to gain possession when the borrower defaults, even thought the loan was secured with the asset.

The riskier the firm that seeks financing, the greater, the incentive for the supplier of capital to make the arrangement a lease rather than a loan.. Many supplier of capital are either lenders or lessors but not both. In some cases loans are converted to lease when the risk of default has increased significantly. The extent that any of the ex-ante costs of bankruptcy avoided by lease as opposed to debt financing are passed on to the lessee in the firm of lower lease payments than otherwise would be the case the firms might haves an incentive to lease instead of borrowing.

Effect of Differing Taxes:-

The dominant economic reason for the existence of leasing is that companies, financial institutions, and individuals derive different tax benefits from owning assets. The greater the divergence in these benefits, the greater the attraction of lease financing overall, all other things staying the same. The tax benefit associated with owning an asset is the tax shield afforded by the deduction of depreciation over the depreciable life of the asset.

If the effective tax benefits associated with owning an asset where the same for all economic units in the economy and if capital markets were perfect in every other way, debt and lease obligations would be valued in the same manner. As a result, their cost would be the same. If the lessor did not lower lease payments to give the lessee all the tax benefits of ownership, the prospective lessee could simply purchase the asset and finance it with debt. In this way it could avail itself of all the tax benefits. Therefore, it is not the existence of taxes per se that give rise to leasing being a thing of value, but it is a situation in which different companies, financial institutions and individuals have different abilities to realize the tax benefits.

Different tax rates among economic units in the economy:-Differences in personal and corporate income tax rates and differences in tax rates among various individuals and corporations.

Different levels of past and current taxable income among economic units:-Example:-a company that carries forward a tax loss and pays little or no taxes.

Different effects related to the alternative minimum tax: - The presence of the alternative minimum tax (ATM) causes divergences in the ability of different corporations and individuals to fully use accelerated depreciation and the deduction of interest as an expense. Such as a company with a redundant tax deductions will have an incentive to lease finance because the lease payment is not classified as a preference item when computing the ATM. companies not so affected will have an incentive to act as lessors.

A company that pays little or no taxes may lease an asset. From another party that pays higher taxes. The lessee gets part of the tax benefits of ownership because its lease payments re lower than they would otherwise be. In turn, the lessor is able to use the full tax credit, which might not otherwise be available to it. As a result, both parties' lessor and lessee gain.

Market Equilibration Process:-

How much realization of the tax benefits the lease is able to achieve depends on the supply and demand conditions in the market for lease financing. A lessor is unlikely to give up all the tax benefits, because realization of such benefits depends on its favorable tax situation. By the same token, competition among lessors will ensure that part of the benefits will be transferred to the lessee in the form of lower lease payments than would otherwise be the case. The exact sharing of the tax benefits is negotiable, but it will depend on equilibrium conditions in the capital markets.

The economic benefits passed off to the lessee are reflected in the implied in interest cost of the lease. By concentrating on this cost and the economic benefits associated with leasing relative to those for borrowing, the firm is able to determine whether lease financing is promising. It also is able to better shop around among lessors and to negotiate the lease. In this way the decision will be grounded in sound economic reasoning, as opposed to the sales pitch used by many a leasing company to sell its financial service.

Other Alleged Advantages:-

In addition to these reasons discussed above, there may be other reasons for the existence of lease financing. For one thing, the lessor may enjoy economics of scale in the purchase of assets that are not available to the lessee. Also the lessor may have a different estimate of the life of the asset, of its residual value, or of the discount rate than the lessee. Moreover, the lessor may face different borrowing costs than the lessee. Finally, the lessor may be able to provide expertise to its customers in equipment selection and maintenance (Van Horne, 2002; 556-558).

2.1.9 Sources of funds for lease financing

A number of financial institutions and special leasing companies provide funds for leasing. A firm seeking funds for this purpose will find a variety of institutions competing for its business.

Banks: - Large commercial banks have become increasingly interested in lease financing. Either directly or through the use of a holding company, a bank will make arrangements to purchase equipment and lease it to a customer. This allows the bank to provide an additional service, which helps it to attract the customer for other business and financial services.

Life insurance companies: - These firms have become prominent in the long term leasing of real estate. A life insurance company has large cash inflows that must be invested until needed to make payments on policies. These monies are frequently invested in office buildings or warehouses, under a financial, service or operating lease.

Financial service companies: - Commercial finance companies and leasing companies are important sources of funds for specialized equipment and machinery. These companies usually employ a staff of experts who are thoroughly familiar with the resale market for specialized equipment and who can therefore develop the terms of the lease agreement.

2.1.10. Leasing versus owning analysis

There are different methods to analysis leasing versus owning decision.

Present value of after tax cash outflow method

Net advantage to leasing method (NAL method)

Internal rate of return method (IRR method)

2.1.11 Present value of after tax cash outflow method

The most popular method of analysis of leasing versus owning decision is a comparison of present value of cash outflows for each of the alternatives. According to this method, whichever alternative has lowest present value of after tax cash outflow is the most desirable. As leasing is analogous to borrowing, an appropriate discount rate for discounting the after tax cash flow might be the after tax cost of borrowing. The use of this rate assumes that the firm's future taxable income will be sufficient to utilize fully the tax shield associated with lease payments. Moreover we assume this rate remains constant through the lease period.

Compute the present value of after lease rent.

End of period

PV (L) = Lt (1-) PVIFA K_{dT} n

Advance payment

PV (L) = L0 + Lt × PVIFA kdT, n- 1 years –Lt (T) PVIF kdT, n^{th} year

Compute the present value of borrow and buy.

Step-1. Calculation of installment.

Installment (Payable at the end of year) = <u>Cost of asset</u>

$PVIFA_{kd,}\ n$

Installment (Advanced payment) = <u>cost of asset</u>

$1+PVIFA_{kd,}\ n-1$

Note: -Lease rent and installment are payable at the end of period. (If no information is given)

Use after tax cost of debt kdt is discount factor (If there is no information)

Step-2. Preparation of loan amortization (repayment) schedule. (Separation of interest and principle)

Year	Installment	Interest	Principal	Loan balance

Where,

Interest = Loan balance beginning of the period × Interest rate

Principal = Installment –Interest

Loan balance = Loan balance of previous period – Amount of principal for the period

Step -3.Calculation of Depreciation and salvage value after tax.

Depreciation per annam = <u>Cost of assets - Book salvage value</u>

Life

Salvage value after tax = Cash salvage value ± tax = 0

Step -4. Calculation of cash flow after tax. (CFAT)

CFAT = Installment – tax saving on interest and depreciation – salvage value after tax.

	(a)	(b)	(c)	(b +c) × T (d)	(e)	(a-d-e) (f)

Year	Installment	Interest	Depreciation	Tax saving on interest and depreciation	Salvage value after tax	CFAT

Step -5. Calculation of PV of after tax cash flow. (CFAT)

Year	Cash flow(CFAT)	PV factor@........%	PV

2. Compare the present value of after tax cash outflow and accept the alternative having lower present value or cost.

Net Advantage of Leasing (NAL Method)

NAL is the difference between the cost of owning and cost of leasing. In other words, it can be defined as the benefit of leasing over purchasing alternative. Lessee should use lease alternative if NAL is positive.

Symbolically,

NAL = Cost of owning – Cost of leasing

NAL = I_0- PV of ownership benefits- cost of leasing

NAL = I_0 - [ITC + D (T) PVIFA (k_{dT}% ,n) + After tax salvage value × PVIF ($k_{dT,}$ n)] – L_t (1-T) PVIFA ($k_{dT\,,}$ n)

Decision:

If NAL is positive, lease the asset.

If NAL is negative, purchase the asset.

IRR Approach

Instead of computing the present value of the cash outflows for two financing alternatives, we could compute the internal rate of return (IRR). This approach avoids the problem of having to choose a rate of discount. In this approach IRR (percentage cost of leasing) is the rate of discount that equates the cost of assets with the present value of cost of lease payments, net of their tax shields.

IRR can be computed using following equation:

I_0 - ITC - D (T) PVIFA $_{r\ n}$ –After tax salvage value × PVIF $_{r,\ n}$ - L_t (1-T) PVIFA $_{r,\ n}$ = 0

Or,

Step -1. Calculation of depreciation per annam and salvage value after tax.

Depreciation per annam = Cost of asset – Book salvage value

Life

Salvage value after tax = Cash salvage value a ± Tax =0

Step -2.Calculation of differential cash flow after tax i.e. cash flow under leasing – cash flow under owning.

Year	Cost of asset (1)	Lease payment (2)	Depreciation (3)	Differential tax saving (4)=(2-3)×0.40	Salvage value after tax (5)	differential cash flow (6)= 2-4

Step-3.Calculation of true factor = Cost

Average cash outflow.

Step-4

By interpolation.

$$IRR = LR + \frac{NPV_{LR}}{NPV_{LR} + NPV_{HR}} \times (\text{Percentage of higher rate - Percentage of lower rate})$$

NPV ignoring sign.

Compare the internal rate of return (IRR) with after tax cost of debt (K_{dT})

Decision:

If IRR(% cost of leasing) < kdt (cost of debt after tax) = Lease the asset.

If IRR(% cost of leasing) > kdt (cost of debt after tax) = Purchase the asset

For example:-

The XYZ company is confronted with the decision of whether the company it should purchase or lease a new Toyota Car. The car can be leased on an eight years contract for Rs.4978.22 a year or it can be purchased for Rs.26, 000. The salvage value after eight years is Rs.2, 000. The company uses straight line depreciation. The discount rate applied is after tax cost of debt. The company can borrow at 15 percent and has a 40 percent marginal tax rate and a 12 percent cost of capital. Analyze lease versus purchase decision using following methods.

PV of after tax outflow method.

Net advantage of leasing method.

Internal rate of return approach.

Solution:-

By using after tax cash outflow method.

Given,

Cost of machine (I_0) =Rs.26, 000

Lease period = 8 Years

Lease rent (L_t) = 4, 978.22

Tax rate (T) = 40%

Depreciation method = straight line

Salvage value (SV_n) =2,000

Before tax cost of debt (k_d) =15%

After tax cost of debt (k_{dt}) = 15% (1-0.40) = 9%

Cost of capital (k_d) =12%

Lease or purchase =?

Alternative 1: Lease alternative

Present value of cost of leasing

Year	Lease rent (1)	Tax saving on Lt @ 40% (2)	After tax lease rent (CFAT) (3)	PVIFA 6%,3 Years (4)	PV of CFAT (5)
1-8	Rs.4,978.22	Rs.1,991.288	Rs.2,986.932	5.5348	Rs.16, 532.07

Or,

Cost of leasing = Lt (1-T) PVIFA K_{dT} n

= Rs.4, 978.22 (1- 0.40) PVIFA 9%, 8 years

= Rs.4, 978.22 × 0.60 × 5.5348

= Rs.16, 532.07

Borrowing and buying alternative.

Step - 1.Calculation of installment.

Installment (Payable at the end of year) = <u>Cost of asset</u>

PVIFA $_{kd,}$ n

= <u>Rs.26, 000</u>

PVIFA 15%, 8

= <u>Rs.26, 000</u>

4.4873

= Rs.5794.13

Step -2.Preparation of loan amortization schedule.

Year	Installment	Interest @ 15%	Principal	Loan outstanding
0	---	---	---	Rs.26,000
1	Rs.5,794.13	Rs.3, 900	Rs.1,894.13	Rs.24,105.87
2	Rs.5,794.13	Rs.3,615.880	Rs.2,178.2496	Rs.21,927.62
3	Rs.5,794.13	Rs.3,289.143	Rs.2,504.987	Rs.19,422.6335
4	Rs.5,794.13	Rs.2,913.395	Rs.2,880.735	Rs.16,541.8985
5	Rs.5,794.13	Rs.2,481.285	Rs.3,312.845	Rs.13,229.0535
6	Rs.5,794.13	Rs.1,984.358	Rs.3,809.772	Rs.9,419.2815
7	Rs.5,794.13	Rs.1,412.892	Rs.4,381.238	Rs.5,038.4235
8	Rs.5,794.13	Rs.755.7065	Rs.5,038.4235	------------

Working notes:

Calculation of interest.

We have,

Interest =Loan balance beginning of the period × Interest rate

1st year = Rs.26, 000 × 15% = Rs.3900

2nd year =Rs.24,105.87 × 15% =Rs.3, 615.88

3rd year =Rs.21, 927.62 ×15% =Rs.3 289.143

4th year = Rs.19, 422.6335 ×15% =Rs.2, 913.395

5th year = Rs.16, 541.8985 ×15% =Rs.2, 481.285

6th year = Rs.13, 229.0535 ×15% = Rs.1, 984.358

7th year =Rs.9, 419.27 ×15% =Rs.1, 412.892

8th year =Rs.5, 038.4235 ×15% = Rs.755.7056

Calculation of principle

Principle = Installment - Interest

Step - 3.Calculation of salvage value after tax and depreciation.

Depreciation per annam = $\frac{\text{Cost of asset – Book salvage value}}{\text{Life}}$

$= \frac{\text{Rs.26, 000 - 2000}}{8}$

Depreciation = Rs.3, 000

Salvage value after tax = 2,000 ± 0 = 2,000

Step – 4. Calculation of CFAT

CFAT = Installment – tax saving on interest and depreciation – salvage value after tax

Year	Installment	Interest	Depreciation	Tax saving on interest and depreciation	Salvage value after tax	CFAT
1	Rs.5,794.13	Rs.3,900	Rs.3,000	Rs.2,760	-----	Rs.3,034.13

2	Rs.5,794.13	Rs.3,615.8805	Rs.3,000	Rs.2,646.3522	-----	Rs.3,147.78
3	Rs.5,794.13	Rs.3,289.143	Rs.3,000	Rs.2,515.6572	-----	Rs.3,278.47
4	Rs.5,794.13	Rs.2,913.395	Rs.3,000	Rs.2,365.358	-----	Rs.3,428.77
5	Rs.5,794.13	Rs.2,481.285	Rs.3,000	Rs.2,192.514	-----	Rs,3,601.62
6	Rs.5,794.13	Rs.1,984.358	Rs.3,000	Rs.1,993.7432	----	Rs.3,800.39
7	Rs.5,794.13	Rs.1,412.892	Rs.3,000	Rs.1,765.1568	----	Rs.4,028.97
8	Rs.5,794.13	Rs.755.7065	Rs.3,000	1,502.2826	2,000	Rs.2,291.89

Step -5. Calculation of CFAT

Year	CFAT	PV factor @ 9%	
1	Rs.3,034.13	0.9174	Rs.2,783.51
2	Rs.3,147.78	0.8417	Rs.2,649.49
3	Rs.3,278.47	0.7722	Rs.2,531.63
4	Rs.3,428.77	0.7084	Rs.2,428.94
5	Rs,3,601.62	0.6499	Rs.2,340.69
6	Rs.3,800.39	0.5963	Rs.2,266.17
7	Rs.4,028.97	0.5470	Rs.2,203.85
8	Rs.2,291.89	0.5019	Rs.1,150.28
Total PV of cash outflow			Rs.18354.56

Decision: Hence present value of after tax cash outflow under leasing alternative is Rs.16532.07 which is less than the present value of after tax cash outflow under purchasing alternative is Rs.18,354.56 .Therefore XYZ company should accept leasing alternative.

By using NAL method

We have,

NAL = I_0 - [ITC + D (T) PVIFA (k_{dT}% ,n) -After tax salvage value × PVIF ($k_{dT,}$ n)] – L_t (1-T) PVIFA ($k_{dT\ ,}$ n)

=Rs.26, 000 – [0 + 3, 000(0.40) PVIFA 9%,8 years +2, 000 × PVIF 9%, 8 years] - 4,978.22(1- 0.40)

PVIFA 9%, 8 years

. = Rs.26, 000 – Rs.1, 200 ×5.5348 - Rs.2, 000 × 0.5019 - Rs.29,86.932 × 5.5348

= Rs.26, 000 – Rs.6, 641.76 - Rs.1,003.80 - Rs.16,532.07

=Rs.1, 822.37

Decision: The Company should choose leasing alternative because the net advantage to leasing is positive. In other words, Company can save Rs.1822.37 by using leasing alternative.

By using internal rate of return analysis

Step -1. Calculation of depreciation per annam and salvage value after tax.

Depreciation p.a. = Cost of asset – Book salvage value

Life

= Rs.26, 000 –Rs.2,000

8

= Rs.3, 000

Salvage value after tax =2,000 ± 0 = 2,000

Step -2.Calculation of differential cash flow after tax i.e. cash flow under leasing – cash flow under owning.

Year	Cost of asset	Lease payment	Depreciation	Differential tax saving	Salvage value after tax	differential cash flow

	(1)	(2)	(3)	(4)= 2-3 ×0.40	(5)	(6)= 2-4
0	Rs.26,000					Rs.26, 000
1		Rs.4,978.22	Rs.3, 000	Rs.791.288		(Rs.4,186.932)
2		Rs.4,978.22	Rs.3, 000	Rs.791.288		(Rs.4,186.932)
3		Rs.4,978.22	Rs.3, 000	Rs.791.288		(Rs.4,186.932)
4		Rs.4,978.22	Rs.3, 000	Rs.791.288		(Rs.4,186.932)
5		Rs.4,978.22	Rs.3, 000	Rs.791.288		(Rs.4,186.932)
6		Rs.4,978.22	Rs.3, 000	Rs.791.288		(Rs.4,186.932)
7		Rs.4,978.22	Rs.3, 000	Rs.791.288		(Rs.4,186.932)
8		Rs.4,978.22	Rs.3, 000	Rs.791.288	Rs.2,000	(Rs.6,186.932)

True factor = Cost / Average cash outflow

= Rs.26, 000. / (Rs.4, 186.932 × 7 + Rs.6, 186.932)/8

= 5.8599

Referring PVIFA table in 8 years row the factor 5.8599 is nearest to 5.7466 which is corresponding to 8%, therefore try at 8%

Try at 8%

Year	Cash flow	PV Factor @ 8%	PV
0 1-7 8	Rs.26, 000 (Rs.4,186.932) (Rs.6,186.932)	1 5.2064 0.5403	Rs.26, 000 (Rs.21, 798.84) (Rs.3, 342.80)
		NPV	Rs.858,36

NPV is positive therefore try at lower rate i.e.7%

Try at 7%

Year	Cash flow	PV Factor@ 7%	PV
0 1-7 8	Rs.26, 000 (Rs.4,186.932) (Rs.6,186.932)	1 5.3893 0.5820	Rs.26, 000 (Rs.22,564.63) (Rs.3, 600.79)
		NPV	(Rs165.42).

By interpolation.

IRR = LR + $\dfrac{NPV_{LR}}{NPV_{LR} + NPV_{HR}}$ × (Percentage of higher rate - Percentage of lower rate)

= NPV ignoring sign.

$=7\% + \dfrac{165.42}{165.42+858.36} \times 8\% - 7\%$

=7% + 0.1616%

IRR = 7.1616%

Decision: IRR can be defined as percentage cost of leasing. Here, percentage cost of leasing 7.1616% is less than the percentage cost of purchasing i.e. after tax cost of debt 9%. Therefore, company should choose the lease financing alternative.

2.1.10.1 Factors Affecting Leasing Versus Owning Decision

Various factors affect leasing versus owning decision, mainly required rate of return, maintenance cost, expected salvage value, obsolescence cost, method of depreciation etc after the decision. These factors are discussed below.

Different rate of required rate of return of lessee and lessor:-If the lessor has a lower required rate of return than the lessee, leasing will be cheaper to lessee than owning. Where as if the lessee has lower required rate of return than the lessor's required rate, it would seem more profitable to by than the to lease.

Maintenance cost:-In some lease contract basically in case of operating lease contract lessor is responsible to bear maintenance cost. In such cash, maintenance cost is normally included in lease rent. If maintenance can be performed more cheaply by lessor leasing alternative may be preferable.

Expected salvage value:-Since the lessor owns the property at the expiration of the lease, it reduce cost of owning. In other words, if expected salvage value is higher, purchasing alternative may be favourable.

Obsolescence cost: - Lease cost are frequently assumed to be lower due to high obsolescence costs. But risk of obsolescence may increase lease rent.

Tax rate: Another important factor that affects lease versus purchase decision is different in lessor's and lessee's marginal tax rate. If the lessor's tax rate is lower than the users tax rate or if there are tax subsidies available is the lessor which is not for user, there will be an advantage to leasing over owning.

Method of depreciation: - Amount of tax saving on depreciation reduces the amount of lease rent. If lessor usages accelerated depreciation and lessee usages straight live depreciations (when purchased) leasing alternative will be desirable over purchase.

2.3 Review of previous studies

In the area of leasing business the previous research work have done. But there are not many research works were found related to this topic. In the context of Nepal there is no various research works about leasing business.

There are some articles and research studies found relevant to the topic of the researcher.

Leasing Business In Nepal Concept And Implications (Rima Devi Shrestha)

Leasing is undeniably a business that has remained highly underexploited in Nepal, despite plenty of potential. In the global context, leasing is being increasingly used as an alternative vehicle of earning, as it offers tremendous prospects to both business and investors in maximising their wealth.

Process

Leasing is a process by which a firm can obtain the use of certain fixed assets for which it must make a series of contractual, period, tax deductible payments. When entered into a contract, the leasing involves at least two parties: lessee and leaser. The lessee is the tenant who holds a lease; he is the leaseholder who receives the services of the asset under the lease contract. Similarly, the leaser is the owner of the assets. The relationship between the tenant and the landlord is called a tenancy, and can be for a fixed or an identified period of time, which is usually called the ‘Term of Lease.’ The consideration or payment for the lease is known as rent.

Leasing business holds tremendous potential in Nepal. One very important rationale behind promoting the leasing practices in Nepal is that owning a business or property through purchase incurs a lot of investment, but leasing saves such big investment. Leasing offers the lessee to use the property productively without having to incur any big investment at all. Relieving the businesspeople out of the initial cash outlay on property is one of the best advantages of leasing.

Another equally important benefit is that it provides tax savings from expenses incurring in the leasing business. It is a good offer to the managers and business owners who always try to maximize their wealth by minimizing expenses.

Likewise, in this business world with rapidly changing technology, leasing also protects the business people from adverse effects stemming from technology changes in the world. As they - when leasing fixed assets like land and building - have not invested big amounts of money in long-term assets, they do not need to bear losses from the technology change which would otherwise hit them at least to the extent they have invested in the fixed assets.

Capital assets may fluctuate in value. Leasing shifts risks to the leaser. Leasing also may provide more flexibility to a business which expects to grow or move in the relatively short term, because a lessee is not usually obliged to renew a lease at the end of its term.

However, one should be aware of a common drawback of leasing. A net lease may shift some or all of the maintenance costs onto the tenant. Similarly, the leaser may demand higher rentals if the business becomes successful. To avoid such circumstances, terms and conditions should be clearly mentioned in the leasing contract.

In the Nepalese context, the leasing business has been least addressed and practised. Only a few companies, namely International Leasing and Finance Co, Union Finance Ltd, Sri Lanka Merchant Bank Ltd. and have conducted leasing business activities. The multitude of companies that are struggling to grab their pie from the toughly competitive traditional banking market in the Nepalese financial sector market have failed to capitalize on the tremendous potential existing in the leasing business.

A number of environmental factors are responsible for the poor growth of the leasing business in Nepal. First of all, most people do not have even a basic concept about leasing, while even those few doing this business lack a broader concept about leasing. As this business has grown in both breadth and depth in international practices, the leasing business in Nepal should also be conducted in compliance with global practices and standards.

At present, the leasing business is being regulated by the Contract Act. There are no leasing regulations in Nepal, and the central bank, Nepal Rastra Bank, is also required to look into it.

The companies practising leasing business in Nepal have been weak not only in informing the people about the business but also in creating adequate demand for it. The companies should also put forward the demand to enact separate legal provisions for conducting the leasing business.

There is also a need for learning from international leasing practices, which may be properly replicated in Nepalese practices, too. There are many instances where leasing is far more advantageous than owning.

Separate law

A separate Leasing Act is essential for facilitating and supervising the leasing business in the country, so that the business activities do not divert from the planned course and produce good results. The existing Contract Act and other related laws are not adequate to properly address the emerging needs of the leasing business.

2.3.1.Review of the previous thesis

Mr. Ramesh Prasad Joshi, in his study "A study on Equipment leasing Business in Nepal" an unpublished Masters degree thesis T.U. 2003/ Feb, has made a through study on how the equipment leasing business is done. His main focus area of study were practice and procedures followed in course of leasing business and analysis of existing legal provisions related to the leasing business.

After the whole study, he concludes that the leasing business in Nepal is in its infancy stage and is in stage of experimentation. He says that the leasing business has been overlooked subject within the Nepalese financial sector. He states that even the pioneers of the leasing business have not taken the leasing as the first priority. He found that lessor companies have the more rights less responsibilities where as lessee has the less rights more responsibilities.

He found that finance companies are not entering into leasing business mainly due to the high credit risk and lack of market. He further found that majority of the finance companies have thought that existing infrastructure for carrying leasing business is not sufficient and are also not satisfied with the provision made regarding leasing business by NRB. He found that the machinery and tools for small and medium scale industries need to be focused to develop leasing business in the country.

Mr. Amish Shrestha, in his study problem and prospects of leasing business in Nepal. He found leasing business in Nepal is only about nine years old and only four finance companies enter into leasing industry. All the finance companies have different ways of treating the lease finance and this indicates the need of separate law. He further aids that the lease contract has kept the lessor at the safe side and free of many responsibilities. He found the political and economic situation of the country improves then the leasing industry can be view as the cupid in the horizon and leasing business in Nepal has brighter future.

Singtan Buddhiman 2007 in his studies focused on the background knowledge of leasing business and identifies the research gap prevailing in the leasing sector of Nepal and justifies the need of research. He found that there is no any vision and clear act about leasing by the governance.

Through the study he found that all the finance companies require certain deposit or security to secure the performance of lease agreement. Lessee has lesser right & power than the lessor, Lessee can't alter, transfer attaches, improve &pledge without prior consent of the lessor. Lessee is required to keep the asset in good condition and functioning all the respect as his own cost.

CHAPTER 3
RESEARCH METHODOLOGY

Introduction

Research is a systematic and organized effort to investigate a specific problem that needs a solution. Research is undertaken not only to solve a problem existing in the work setting, but also to add or contribute to the general body of knowledge. Research is thus knowledge building process.
"Research is a depth study and search for any particular topic, subject or area of investigation, backed by the collection, compilation, and interpretation of relevant details or data. It is a careful search or inquiries into any subject or subject matter. The process of searching again and again is known as research." (V.p. Michael, Research Methodology in Management. Himalayan Publishing House 1997-page 2)
Thus, research methodology is the process of arriving to the solution of the problem through planned and systematic dealing with collection, analysis and interpretation of data. It consists of the research design the nature and sources of data, sampling procedure, data and information collection procedure and the method of presentation and analysis of data. Some of the limitation of the methodologies applied in this research has also been mentioned at the end of this chapter.

Research design

Research design is like a philosophy of life. It refers to the overall framework of the research. Research design is the plan, structure, and strategy of investigation. It focuses on the data collection methods, the research instruments utilized, and sampling plan to be used. It is an integrated approach that guides the researcher in formulating, implementing and controlling the study. This research study is basically an attempt in disclosing the current picture of leasing business of finance companies in Nepal. Therefore it has been directed towards finding out facts and view on the problems and prospects of leasing business in Nepal. Depending upon the nature of the study survey and directs interaction were followed to gather and join all the facts about leasing business of finance companies and its problems and prospects.

Population and sample

Total population or the universe means the total population or the entire group of sample. A sample is defined from only a portion or subset of the universe or population.

The population of this study consists of finance companies, which are doing leasing business. There are four finance companies performing leasing business in Nepal. Out of which three companies are located in kathmandu valley and rest another one is outside the valley. For this study comprise all the finance companies licensed from Nepal Rastra bank presently operation in the country a tub case of study of problem and prospects regarding leasing business, the population covers only the 3 finance companies performing leasing business in Kathmandu valley.

Sampling procedure

There are in total 78 finance companies currently operation in the country. Only four finance companies are doing leasing business in the country. For the purpose of the analysis of problem and prospects of leasing business in Nepal, the three finance companies located at valley have been selected which is doing leasing business in Nepal, which is covers the 75 percentage of the finance companies which is doing leasing business in Nepal.

Data collection procedure

This study aims to find the problems and prospects of leasing business in finance companies that are doing leasing business in Nepal. This study has used published and unpublished sources of information. These studies also studies also used to the publications of Nepal Rastra Bank have been utilized as a secondary source of information. The official papers, annual report and other document have been utilized as a source of information for the fulfillment of the objective.

Data presentation and analysis

The basic objective of the study is to find problems related to leasing business in finance companies of Nepal. The procedure for presentation and analysis has been intended to use more tools and technique applicable for the study and data has been presented in tables, graphs and figures in an appropriate place. Further more mathematical and statistical tools like percentage analysis, trend analysis ranking and variance test are also used in the required place.

Limitation of methodology

The study is an attempt to find the problems faced by finance companies regarding leasing business and highlighting abut its prospects in the context of Nepal. Finance companies carrying leasing business locates at Kathmandu valley have been selected as sample.

In order to collect and analyze facts and views of finance companies about leasing business in Nepal, finance companies located at valley which is doing leasing business only have been selected. Hence, the study is limited to the study of finance companies locates at valley. In this case, generalization made by the study may not represent the finance company located at outside the valley which is doing leasing business.

CHAPTER -4

DATA PRESENTATION AND ANALYSIS

Presentation & Analysis of Data

The basic objectives of the study are to present data and analyze this. This chapter also includes the presentation and analysis of qualitative as well as quantitative data and information to achieve the stated of the study.

The study is based on five fiscal years. Simple we take 5 fiscal years in such types of study fiscal year 2003 to 2007 the study is concerned.

Beginning of the leasing business in Nepal

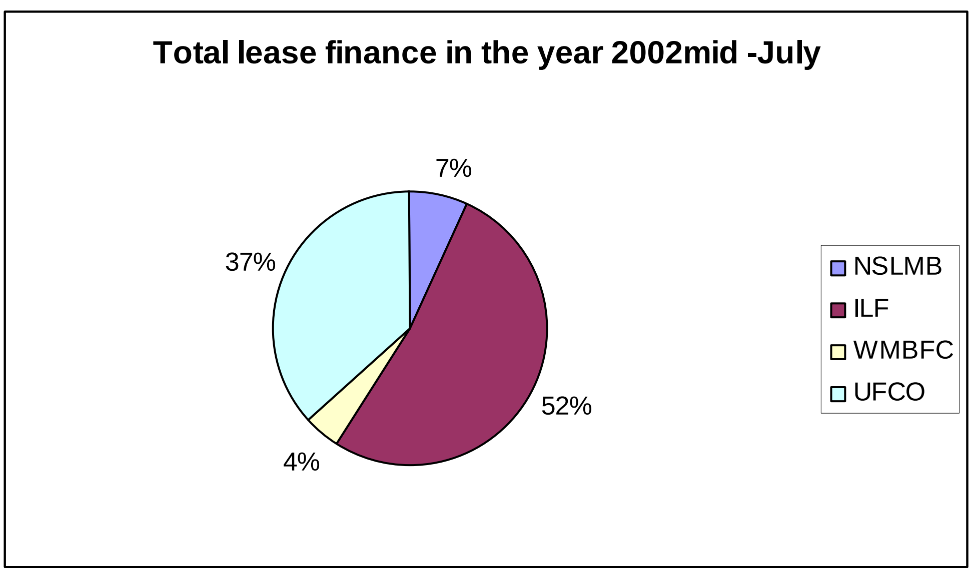
Leasing business of Nepal is a new concept of the finance companies to finance the organization or an individual to acquire an asset, which can benefit both the users and the financer. This concept of method is only about twelve years old. Leasing business in Nepal started with operation of finance company named "Union Finance Company" on 21st of Mangshir in 2051 B.S. It was the first step of entering of leasing business in Nepal, done professionally by the finance company. Rs. 26.3 million was invested in lease finance by UFCO. Then other two finance companies named "International leasing and Finance Company" and "Nepal Sri Lanka

Merchant Bank" also joined the market of leasing in 2052 B.S. The three finance company's total investment in the year 2052/253 B.S. stotted at Rs. 54.5 million. This shows good indication of probable growth of leasing business in Nepal. And it was lately the "World Merchant Banking and Finance Company Ltd." Which entered the finance industry doing leasing business also in the mid of the year 2058 B.S. in Hetauda.

Lease finance outstanding as of mid July 2002 stood at Rs. 363.6 million representing 3.04% of the total credit granted by finance companies, which includes Rs. 13.3 million from "World Merchant Bank and Finance Company Ltd." Hetauda. And rests are from the finance companies of Kathmandu valley that are performing leasing business, in which major portion of around Rs. 191.4 million is from ILFC. And the share of UFCO and NSLMB are Rs. 133.1 million and Rs.25.8 million respectively. The above discussion is presented in pie chart shown below.

Chart no.1

Pie Chart showing percentage share of individual finance Co's (of total Lease Finance in the year 2002, Mid-July)



Pie-chart created from the information based on the data of the NRB's Non-Bank Financial Statistics No.5 (Mid-July2002)

The Chart no. 1 shown above clearly shows that 52% of the Lease finance has been done by International Leasing and Finance Company; making company the market leader. Then followed by Union Finance Company covering 37% of the total lease finance. The other two finance companies have very marginal share in the lease finance of only 7% by Nepal Sri Lanka Merchant Bank and 4% of World Merchant Banking and Finance Company. This clearly shows that there are only two market leaders and indicates Nepal’s infantry stage of the leasing business.

Analysis of growth & development of financial institution in Nepal

With the economic liberalization the financial sector has expanded substantially in Nepal. The Nepalese economy is rapidly integrated with the global economy with its outward oriented policies followed by membership of WTO, SAFTA and BIMSTEC. The country is in the process of institutional restructuring of financial sector.

When the country adopted open liberal and market oriented economic policy from mid 1980's there came remarkable development in the Nepalese financial system. In the banking sector many joint venture as well as Nepalese private sector. Banks, came into fray and in the non banking sector, large number of finance companies were established. Besides many development banks, saving & credit cooperatives were established in the financial system. Starting from the early 1990's, the number of finance companies has been growing rapidly. In 2000 it was 47 in number. It increased by 53.19% compared to 2000 and to 78 in mid July 2008. However majority of the finance companies are operating within kathmandu Valley. The total finance companies, 62 are being operated in central regional and the rest are being operated other four regional till 2008. (Source: - Micro economic indicators of Nepal, July 2008)

Growth of financial institutions

Table no. 2

Type of financial institution	No. of institutions in Mid-July , 2008										
Year	1980	1985	1990	1995	2000	2003	2004	2005	2006	2007	2008
Commercial bank	2	3	5	10	13	17	17	17	18	20	25
Development bank	2	2	2	3	7	11	15	26	29	38	58
Micro finance development bank	-		-	4	7	11	11	11	11	12	12
Finance companies				21	45	57	58	60	70	24	78
Financial cooperatives	-		-	6	19	20	20	20	19	17	16
Financial NGOs	-		-	-	7	39	43	46	47	47	46
Insurance companies						17	17	19	21	21	25

Total	4	5	7	44	98	172	181	199	215	179	260

Source: - (Micro economic indicators of Nepal, July 2008)

There is a tremendous growth in the number of financial institution in Nepal in the last two & half decades at the beginning of the 1980s when financial sector was not liberalized, there were only two commercial banks and two development banks performing banking activities in Nepal. There were no micro credit development banks, finance companies, cooperatives and NGOs with limited banking transactions. After the liberalization of the financial sector, financial sector has made a hall mark progress both in terms of the number of financial institutions and beneficiaries of financial services.

Shown in the above by mid-Jan 2007, NRB licensed bank and non-bank financial institutions totaled 260. Out of them, 25 are commercial banks, 58 development banks, 78 finance companies, 12 micro credit company-operatives and 46 NGOs in Table-2

Analysis of Growth and development of leasing business in Nepal

According to the provision made finance companies act 1986, finance companies are legally allowed to make available leasing finance to any individual firm, company or institutions for the purchase of vehicles, machinery tools, equipment, durable household goods or other similar movable property. Though the finance companies act is enacted in 1986, there is no any finance company established till 1993. The first finance company is established only in 1993. Since then there is rapid growth in the number of finance companies but leasing business in started only in 1995. For the first time, ILFC, NSMB and UFCO start the leasing business in

Nepal. Similarly world merchant Bank & Finance Company also started the leasing business from Hetaunda. The analysis shows following growth of finance companies operating leasing business in relation with the growth of total finance companies. Now the finance companies are operating according to the finance company act 2063.

Table No. 3

Institutional Growth of finance companies Operating Leasing Business.

Year	No. of total Finance Companies	Growth rate of the Year in %	No. of finance companies operating leasing business	Growth rate per year in %	% of finance companies performing leasing business
1992	1	-	Nil	-	-
1993	8	700	Nil	Nil	-
1994	10	25	Nil	Nil	-
1995	28	180	2	Nil	7.14
1996	35	25	3	50%	8.57
1997	41	17.14	3	Nil	7.32
1998	43	4.889	3	Nil	6.98
1999	45	4.65	3	Nil	6.67
2000	47	4.44	3	Nil	6.38
2001	48	2.13	4	33.33	8.33
2002	53	10.42	4	Nil	7.55
2003	59	11.32	4	Nil	6.78
2004	59	0	4	Nil	6.78

2005	63	6.78	4	Nil	6.35
2006	72	14.29	4	Nil	5.55
2007	78	8.33	4	Nil	5.12

Source:- Banking and financial statistics vol. No. 48 Mid January 2008.

Table no.4.2 gives comprehensive view of financial system of Nepal. From this table it has been know that the financial system of Nepal is continuously developing. Different types of financial institutions have been established and their number has also started along with the first establishment of finance company. It was lately in 30th 1995 with the establishment of union finance company the leasing business took its first step. And latter other finance companies named "International Leasing & Finance Company "and " Nepal Sri-lanka Merchant Bank also joined the market of leasing in 1995 (1995-10.31) and 1996 (1996.2.4) respectively and after long time one of the finance company came into existing in the 2001.8.2 A.D. from as a result till the year 2008 only four companies are operating leasing business at one of their investing activity. This indicates that only 5.12% of total finance companies established till the year 2008 are currently doing leasing business. There is lack of attraction towards this leasing business.

Study of Growth of Leasing Business in Nepal

Table no. 4

Table showing total amount of fund used in lease finance by the finance companies and its share & growth in percentage. (Rs.In million)

Year (B.S)	Total Loans and advances	Uses of funds in Lease Finance	Share of Lease in Percent	Percentage Increase in Lease finance
2058/2059	11949.6	363.6	3.04	30.88
2059/2060	14473.7	148.8	1.02	-59.07
2060/2061	17540.8	138.2	0.78	-7.12
2061/2062	21223.3	247.2	1.16	78
2062/2063	270789.5	-	0	
2063/2064	35304.2	-	0	

(Source:NRB Non -Bank Financial Statistics No.48 & Quarterly economic bulletin mid April 2008)

The above table no. 1 also shows the share of lease investment in the total loans and advances. If we analyze the "share of lease in percent" column, we can find that the investment of fund in lease is decrease 2058/59 than in the year 2059/60. That is, there has been proportionate increment in the leasing business in accordance to other investments like loans and advances. We see rather ups and downs in leasing business in comparison to the smooth growth of other investment area of finance companies. At the year 2063/64 there was total loan and advance is Rs. 35304.2 but there is no any extra amount use in lease financing. It shows the leasing business in Nepal is decrease in slowly.

Total use of fund of finance companies in loan and advances

The following table shows the use of fund of finance company in loans and advances also shows the portion of loans and advances using in lease finance.

Table no. 5 In million (Rs.)

Year	Total used of funds	Funds used in loan and advance	Hire purchase	Housing	Term loan	Lease	Other
2003	22116.4	14473.7	2477.4	4211.1	6806.5	148.8	829.9
2004	27198.7	17540.8	3003.2	5331.6	8360.2	287.9	557.9
2005	3043.7	21223.3	3591.0	6807.5	9448.9	247.2	1128.7
2006	38841.2	27056.6	-	-	-	-	-
2007	53035.7	35304.2	-	-	-	-	-

(Source:NRB Non -Bank Financial Statistics No.48 & Quarterly economic bulletin mid April 2008)

The above table shows that loans and advances have reached Rs.35304.2 million in mid July 2007 from Rs. 27056.6 million. in mid July 2006. Registering a growth of 30.48 % the purpose-wise loan showed a mixed trend during the review period. This table also shows in the last two years there is no any extra fund using leasing, hire purchase sector. Only investment of government securities and others sector is given priority in the total loan and advance and also liquid fund and other uses in the last two years.

Growth Trend on Lease Finance in Nepal

Table no.6

Year	Loan and advance in Lease	Trend value
2001	277.8	193.46
2002	363.6	229.26
2003	148.8	265.06
2004	287.9	300.86
2005	247.2	336.66

Source-Quarterly economic bulletin mid July 2008

Forecasted loan and advances in Lease finance

Table no.7

Year	X	Expected Value
2006	3	372.46
2007	4	408.26
2008	5	444.06
2009	6	479.86
2010	7	515.66

For details of calculation refer to appendix-5

Terms used in the Lease Contract

In this part of the analysis, the terms that are used in the lease contract frequently are described in brief.

Applicalbe ate-"Applicable Rate" means a rate of interest defined by the company

Business Day- "Business Day" means a day when banks of the city of Kathmandu are open for business.

Compulsory Acquisition –"Compulsory Acquisition" means requisition for title or other compulsory acquisition of the equipment (otherwise than by requisition of Lease) capture, seizure, detention for any period exceeding thirty days or confiscation of the equipment by any government or by persons acting or purporting to act on behalf of any government.

Equipment- "Equipment" means the equipment described in the schedule together with al or any parts, equipments and manuals.

Initial Rental-"Initial Rental" means the initial rental specified in the schedule provided to the lessee.

Management Fee- "Management Fee" means the certain amount that is payable to the lesser/finance company by the lessee on signing of the contract (which is usually 1-1.5%).

Permitted Lien-"Permitted Lien" means liens or claims for taxes or government charges or levies not yet assessed or if assessed, not yet due and payable or of any repairer, warehouseman, workman or supplier.

Purchase Agreement-"Purchase Agreement" means the agreement, described in schedule provided to the lessee, for the purchase by the lesser of the asset.

Rental-"Rental" means the equal amount of monthly installment payable by the lessee to the lesser as a part o the payment of the leas finance.

Residual Value-"Residual Value" means the price specified in the schedule provided to lessee payable on exercising this option to purchase.

Study and Analysis of Clauses of the Lease Contract

This part of the analysis will help the reader understand about the clauses embedded in the lease contact. As the part of the objective is to find out the most important clauses of the lease contract, the clauses are explained in detail to study analyze the importance of the clause.

4.3.1. Purchase and Delivery

In this clause, lesser appoints the lessee to act as its representative for he purpose of accepting delivery of the asset under the purchase agreement. Delivery of the asset by the lessee and accepting the asset without any reservations by the lessee is deemed to be effective as soon as the asset is delivered to and accepted. If the lessee has paid a deposit and/ or will pay part of the purchase price of the asset to the supplier under the purchase agreement, the lessor will be given credit for such amounts under the purchase agreement. The lessee will not be entitled with any sort of right, title or interest to the asset as a whole or part. The lessee and the supplier are both due to any payments to be made to the lessor in case of cancellation of sale or claim by the manufacturer on the asset. In case the lessee fails to sue the supplier, the lessor may take legal action against the supplier.

The implication of the above clause in the lease contact is to safeguard the lessor or finance company from being decided by the bad intentions through the amalgamation of the lessee and the supplier. The right of the lessor to sue the supplier in case of any default in sale or claim by manufacturer and its right to indemnify lessee for suppliers due are its main importance.

4.3.2 Rentals

As defined in the terms of lease contract, it is te equal monthly installment payable to the lessor. The lessee shall ay to the lessor by such method that both parties agree upon from the time specified to the lessee. Also on the effective date lessee is liable to pay the *initial rental and management* fee if it is due and pay the rental punctually and without demand at the times specified in the schedule of the rentals. If prior to the effective date the lessor is making installment payments regarding the purchase of the asset, the lessee will pay *pre-rentals* to the lessor on those payments. In the case of NSLMB the lease rental is payable at the end of the month.

This clause mentions specifically about the timely payment of all the due rentals withot any demand by the lessor. For the time of payment and the amount of rental the lessor provides a schedule of payment known as loan amortization schedule. This schedule includes all the information about the rentals, principal amount and interest on due amount.

4.3.3 Interest on overdue amounts

If any rental or any other amounts are payable to the lessor under the lease agreement is not paid on due date, the lessor shall be entitled to demand interest on such overdue amounts using default rate as per the rules of the finance company.

This part of the lease contract mentions about the compulsory payment of interest on the overdue rentals to be paid to the lessor. This makes sure that the lessor's receivables are not invested without any interest. And also helps the lessor to get timely payment of the rentals.

4.3.4 Residual Value

The residual value is the value of the asset at the end of the lease period. The lessee may purchase the asset at the end of the contract on payment of the residual value, which is the last payment of the schedule.

This part of the lease contract mentions about the value of the asset at the end of the lease contract. It is the book value of the asset at the end of contract and lessee are usually offered with the same amount to purchase the asset.

4.3.5. Exclusion Clause

The lessor doesn't gives any warranties and doesn't makes any representatives as to the quality, condition, correspondence with description, or suitability for the lessee's purpose of the equipment. And lessor also doesn't authorize any dealer or supplier for any warranties. All warranties and representations implied by law in respect of the equipment are excluded unless it is prohibited by the statue. The equipment is leased and if applicable is sold on an "as is where is" basis. The owner warrants that it will have and on any sale will pass to the lessee only such title as the lessor may acquire under the purchase agreement.

The purpose of the implication of this clause is to notify the lessee that the lessor doesn't take any responsibilities regarding warranties provided by the supplier. Also the dealer or supplier of the asset is not authorized by the lessor to provide the lessee with any warranty. The warranty for assets is only the agreement between the supplier/dealer and the lessee only.

4.3.6. Warranties of the Leased Asset

At the request and expense of the lessee, the lessor will assign to the lessee the benefit of any guarantee or warranty issued by the manufacturer in respect of the asset if the same is assignable.

This clause mentions about the lessor acting as an intermediary between the lessee and the supplier if the supplier provides any warranty. The lessor however will not provide any warranty for asset leased on its own as described in the part (4.4.5).

4.3.7 Operation and Use

The lessee must ensure that the asset is not used in any manner or for any purpose that contravenes any applicable legal provision, any certificate, licenses or registration relating to the equipment or the insurances. The lessee also shall ensure that the asset is not used for which it is not designed or suited.

This clause is introduced in the contract to prevent the misuse of the leased assets (by the Lessee). Misuse in the sense that the lessee must not use the asset for illegal jobs. This clause also makes sure that the leased asset is used only for which it is made.

4.3.8 Maintenance and Repair

Maintenance part explains about the maintenance of the leased assets by the lessee. The lessee shall keep the asset with the parts and all accessories presently installed or replacements made in accordance with the lease finance agreement. The lessee must also keep the asset in good repair, condition and functioning in all respects. The lessee also should comply with all mandatory modifications, service bulletins and similar mandatory requirements applicable to the asset or to any part. The lessee also need to comply with all laws and regulations applicable to the asset for the time being in force and provide the lessor with such evidence as the lessor may require to satisfy that the lessee has complied with the requirements of this clause.

Repair part of this clause explains about the responsibilities of the lessee on the leased asset for its repair in case of any sort of damage. The lessee shall at its own expense promptly repair the asset or any of its parts becomes time expired, lost, or damaged. The lessee shall also need to replace the asset or its parts with the same or of greater utility designed or suitable for the equipment of the asset is damaged beyond repair. All the substitutions, replacements and renewals made in or the asset shall be such that upon installation in the asset they will with out further act or deed be and become legally and beneficially owned by the lessor free of any encumbrances.

The lessor or the authorized agents or representatives have the right to inspect the leased asset at any time upon giving the lessee reasonable prior notice. The thing to be considered is that such inspection should be on such that it shall not interfere with the lessee's scheduled task of the leased asset. The lessee shall furnish to the lessor any information with respect to the asset. Its location, operation and use as the lessor may from time to time reasonably require.

4.3.9 Attachment of Alteration of the leased Asset

The lessees without the prior written notice cannot perform the activities like sell, assign or transfer title to the asset. The lessee also cannot sub-lease, hire, and dispose of the leased asset or part of the leased asset. The lessee is also not allowed to use the asset beyond the lessor's working country. The lessee will do nothing, which could reasonably be expected to result in the asset being confiscated or seized from the possession of the lessee. And in any such event, the lessee will give the lessor immediate written notice thereof and will promptly get release there from the asset.

This clause helps the lessor to maintain the lessee's use of asset in track as per the agreement or as intended by the lessor. The lessor has the right to prevent the lessee from diverting its intended use. This makes sure that the lessor's investment is on the right track and the lessor can be assured of getting his rentals timely, as the lessor has invested the fund seeing the future profits that may earn by the lessee using the leased assets. However, the lessee can give written note asking the lessor to alter the asset for increasing its utility and if the lessor agrees to the lessee's plea, then the lessee can make adjustment to the leased asset on its own expense. This will benefit both the lessor and the lessee.

4.3.10Indemnities to the Lessor

The lessee shall indemnify and keep the lessor indemnified against all the costs and expenses of purchasing, owning, operating, insuring, maintaining and repairing the asset. If the lessee has failed to do so in accordance with the terms of the agreement, the lessee shall reimburse the lessor for all the expeses explained erlier. The lessee also shall indemnify the lesser for all damages, liabilities, claims and expenses, which may be at any time claimed against the lessor by any agent, sub-contractor of the lessee or by any third party arising out of the purchase, use or ownership of the asset.

This clause is set for the protection of the lessor against the expenses made by itself on be- half of lessee. The lessor has the right to claim all the expenses made for leased assets, which is due to the lessee. The lessor is also protected from the claims of the third party relating to the leased asset and the lessee.

4.3.11Insurance of the Leased Asset

All the finance companies require the leased assets to be insured at the lessee's expense. The companies themselves determine the account, coverage and insurer and obtain and maintain insurance policy for the entire period of the lease at the company's name but the lessee pays the premium. The Practices found regarding payment of premium are that lessee can directly pay the insurer or can request the lessor to pay the insurance premium on its behalf. But the option used in ILFC and NSLMB is that the lessee is required to pay the premium through company's account. And such payments made before lease execution are included in the acquisition cost of the asset.

If the insurance is canceled or any material change, which affects the interests of the lessor, the lessee without any injustice to the simplification of the foregoing; the policies shall name the lessor as the owner and warrants no operational interest. The companies also require that at any time, the amount of insurance against loss or damage to the equipment must not be less than the corresponding stipulated loss value after execution date. However, before execution date, the companies themselves in consideration of the stipulated loss value of the first year determine the amount on insurance.

It is greed that should any claim or series of claim exceed the amount of insurance contracted by lessee it shall be considered as self-insured for such excess amounts and shall waive all rights of subrogation against the lessor.

The lessee should always provide with the copies of policies or certificates of insurance to the lessor upon effecting and renewing insurance. And the lessee should produce the receipts of payments of the entire initial, renewal and other premium to the lessor.

As long as there has not been any default by lessee, any insurance amount (other than the total loss), which is received by the lessor, is paid the lessee upon producing the satisfactory evidence to the lessor about proper repair of the damaged asset. If the lessee gets directly the insurance amount (other than total loss) , then the lessee myst use the recovered amount in or towards the repair or replacement of the asset as a whole or its part. And if the lessee receives any amount for the total loss of the leased asset, then the lessee is required to pay the amount received to the lessor/ finance company.

If the lessee fails to provide the renewal of the insurance policy, the lessor may instruct the insurer to renew the policy form the expiry date. Few grace periods in days may be provided before charging the interest in the amount due.

Upon studying the insurance clause of the lease contract, it is found that it is one of the sophisticated clauses in the lease contract. However, it is one of the important clauses of the lease contract, as it covers the risk indulged in any business including the leasing business. As one might know that insurance covers the risk involved in the assets of any type. And it is wise to insure any asset involved, be it for personal use or for business purpose. And for the business purpose, that also for leasing business, insuring the leased asset it the must, as the leased assets can be ruined and it may be difficult for the lessor to get its investment back. So, it can be said that, it helps the lessor to remain safe from the loss that can be occurred due to bad debt (occurred by the damage to the asset and total lost of the asset by fire or theft) by insuring the leased asset with the insurance company. And the lessor has clearly mentioned that the insurance of the leased assets is a must and the amount is payable by the lessee and also any benefits is in the account of lessee (after deducting any amount due.)

4.3.12 Default and payment on Termination

The term default itself refers to the incompetence in performing particular acts and the same is also applied in the lease contract. There are several cases that may cause the lease contract to be deemed as default. The lessor may serve notice terminating the lease, where the lessee shall make all the payment required (as per defined in the payment on termination) and must return the equipment to the lessor if the contract is deemed as default. The cases that may cause the lease contract to consider as default are as follows :

If the lessee fails to pay sum payable under the lease agreement (usually between 5-7 business days) if its becoming due or upon the case of no due date specified in the lease agreement, usually within 5-7 business days after the demand of payment by the lessor.

If the lessee fails to perform the duties of itself as stated in the lease agreement or if the lessee breaches the contract .

If the cheque issued by the lessee dishonors.

If the equipment is arrested, impounded or detained and is not released within 10 business days.

If lessor at its own discretion determines that lessee's business cannot be continued further.

If the information and materials furnished by the lessee to the lessor be shown to have been wrong or misleading in a material respect when made or furnished.

If the lessee files an application for liquidation, bankruptcy or winding up of its business.

So in general the contract is deemed to be default, if the lessee jeopardizes its own business and put the lessor also at risk of loosing the investment.

For the remedies or to cover the loss (in case of default), the lessor has the following rights on the lessee and the leased assets:

The Lessor can without any notice, be entitled to remove and repossess the asset and the lessor will not be responsible for any loss occurred by such deed.

The lessor can recover the entire amount due by rentals for the fixed period of lease.

The lessor can also recover the amounts (other than rental) that are payable by the lessee had the lease agreement continued.

The lessor has the right to sell or dispose off the assets seized under the case of default.

In case of total loss of the leased assets, the lessor has the right to demand the compensation agreed beforehand and the amount equal to the rentals due.

The lessor's rights are the strong points that are made totally for the safety of the uses of funds in the lease finance. The rights on the leased assets in case of default serves as the gateway to solve the problems thus arrives. All the clauses are designed to recover all the amount due that the lessor has right on. However, the lessor shall have to pay the lessee any insurance proceeds if received by the lessor (after deducting the amount due by lessee).

The above discussed are the common and important clauses of lease contract found in the lease agreement that are studied and analyzed. Beside that there are other clauses, which differ from one finance company to another.

4.4 Lease rental calculation Practiced by Finance Companies

Lease rental is the amount paid by the lessee to lessor in installments for providing the lease finance service by the lessor. The practice followed by the finance companies regarding payment of Lease Rental is monthly and the depreciation is charge on diminishing balance method. The interest rate charge for the amount of lease varies from one finance company to another finance companies and also within the company it varies from customer to customer. Usually the regular and prime customer gets the privilege of lower interest rates and the new and juvenile are usually charged normal interest rates and the new and juvenile are usually charged normal interest rates.

As the practices followed by the finance companies for calculating the lease rental is different from one another, the researcher has tried to present and analyze the calculation of lease rental for each finance company separately.

4.5 Practice followed by Union Finance Company

The UFCO has the practice of calculating Lease Rental using the programme called Excel, produced by world-renowned company Microsoft. It does not use any specific software for calculating the lease rental. Neither does it uses any formulae found in the books of finance.

The lease rental is calculated using simple spreadsheet produced by the Microsoft, known as Microsoft Excel. The company defines the amount of assets and then calculates the amount of down payment. The down payment is treated as major rental and placed in the amortization schedule in first place as a part of the monthly rentals. Then the company hypothesize the amount of rental and then uses IRR function available in the excel to find the interest rate (monthly and yearly) using the entire monthly rental including the major rental (here the major rental is treated as expense and is kept in negative figure). Then the excel finds out the rate of return or the interest rate for the hypothesized monthly rental. Then the company uses another function of the excel called "Goal Seek" (found in the sub- menu of the tool bar) to change the interest rate obtained to the desired one. When the obtained rate is changed using "Goal Seek" function, the hypothesized rental then changes automatically to the required rental as needed (as per the interest rate applied in the cell where interest rate of hypothesized rentals was calculated). And thus the Union Finance Company obtains the monthly lease rental. (The residual value is kept Nil while calculating the lease rentals)

This shows that the UFCO doesn't uses any financial formulae found in the books of finance; rather it uses the modern technology, which is faster and much easier to operate.

UFCO charges certain percentage as management fee (usually 1 percent of leas e facility for the old and good clients and 1.5% for the new customers) for propviding lease finance. The lessee is required to pay certain percentage of the lease facility as down payment at the start of the contract and the required amount for down payment is usually 20%-30% (depends upon the dicretion of the company, *it is found that up to 60% was also taken as down payment*). The amount paid as the down payment is taken as a major rental and is treated as other normal monthly rental, i.e. the amount paid as down payment includes the margin/interest and the amount of principal to be deducted formthe total cost of the asset.

A hypothetical example is taken to better understand the treatment of the major rental.

Let the cost of the Asset be Rs. 3,950,000 "CP"

The down payment is 30% of the cost i.e. Rs. 1,185,000 "DP"

The interest rate applied is 16% annually (1.33% monthly/periodically "PR")

The contract period is 3 years (36 months/periods)

The down payment of Rs. 1,185,000 is taken as first and major rental. This includes the amount of Rs. 36,864 [(CP-DP)*PR] as *interest/margin* and the rest i.e. Rs. 1,148,136 (Dp-Margin) is the principal amount that is deducted from the cost of the asset to find out the outstanding amount of principal. The equal monthly rental calculated for this example using Microsoft excel is Rs. 99,376.

4.6 Practice followed by the Nepal Sri Lanka Merchant Bank

NSLMB also uses Microsoft Excel to find out the equal monthly rental. But it uses and additional the software introduced by Merchant Bank of Sri Lanka to calculate monthly rental unlike UFCO and ILFC. The software comes as a package to calculate lease rental, for which the Merchant Bank of Sri Lanka has their own sets of formula, which was not disclosed by NSLMB for the privacy purpose. The software is relatively much easier to use than used by the UFCO, as it is only required to fill up the predefined cells with the information required to calculate the equal monthly rentals. Once the user enters the amount of the lese facility, lease period (in months), effective interest rate the software automatically calculates the rentals. For the privacy purpose NSLMB did not wanted to disclose the details of formulae involved in the software.

NSLMB, while calculating the lease rental, first deducts the down payment from the cost of the asset. Only after the deduction of the down payment, the actual lease rental calculation is made and also the amortization schedule for the equal monthly rental payment. The amount taken as down payment is not treated as the part of the lease payment, rather as the security for the lease contract. The whole amount received in down payment goes straight in the bank's account. This makes the lease contract of the NSLMB is very much similar to the hire purchase. Where, only the outstanding principal after deducting down payment is treated as finance and the treatment is also made only for the principal outstanding at the beginning of the contract. For example, let the cost of the asset be Rs. 100 and the down payment is Rs. 30 (30% of the cost of the asset)., then Rs. 70 is the outstanding principal and Rs. 70 is taken as loan and the equal monthly payment is calculated for Rs. 70 only. While in the pure lease the whole cost of the asset is taken as loan granted and every amount received is the rental, which includes margin and depreciation, which is generally understood as interest and principal.

This kind of practice may e prevailing in this country due to unavailability of separate act for the lease financing which will guide step by step to do the lease financing.

4.7 Practice followed by International Leasing and Finance Company.

The ILFC also uses computer software to calculate the lease rental and to prepare the schedule of payment. The software is the same software as used by its other foreign partners in Korea. The software is simple to use as the required monthly rental is easily obtained once all the required data are input. Due to their policy of not disclosing the details on monthly lease rental calculation, the researcher was unable to gather any information or the formation or the formulae about the lease rental calculation.

The lessee is required to make a down payment (may vary from client to client) as a deposit in ILFC, which is termed as *Key Money*. As UFCO an NSLMB, ILFC also charges some percentage of the cost of the leased asset as management fee (which is around 1-1.5%). Then the whole of the asset is financed and the lease rental is calculated. For example, let the cost of the asset be Rs. 100. Then the amount required to be deposited be 10% (varies from client to client) i.e., Rs. 10. ILFC does not deduct this amount or the key money from the cost of the leased asset. The whole cost of the asset (Rs.100) is taken for the calculation of the lease rental. If 14% annual interest rate and 3 years (36 periods/months) is applied to calculate the monthly lease rental for Rs. 100, then the software of the ILFC calculates lease rental as Rs.3.3783.

The lese rental is payable in advance. The lessee is required to return the asset to the company after the expiration of the contract. The key money or the deposit will be returned to the lessee after the expiry of the contract. However, the lessee is five an option to purchase the leased asset at the predetermined price or to renew the lease agreement on year-to-year basis.

4.8 Problems of Leasing Business in Nepal

Leasing business is new to the Nepalese market. The new ordinance 2004 has given the right to all the financial institution to do leasing business but the paid up capital should be Rs. 15 Crore.

The problems faced by Nepalese leasing business are stated as follows:

The first and the foremost problem that the leasing business in Nepal facing is the lack of the proper and unique act that is solely made for the leasing purpose. The finance companies are required to perform the leasing business according to the provisions made under Finance Company Act, NRB directives and Income Tax Act of Nepal. Every finance company feels the need of the leasing act so that there exist the smooth and parallel way of performing leasing business among the finance companies.

The lack of capital is one of the prominent problems for the finance companies. Due to this the finance companies are not able to invest in the equipments that cost very high. So they are limited only up to financing business like hire purchase of two-wheeler and small four-wheelers, etc. The finance companies with limited low capital need to expand their capital in order to enter the leasing business.

the most common problem faced by all the finance companies is the *recovery problem*. The recovery problem means the delay and default in the payment of the monthly rental. This problem has risen due to the low economic conditions of the country. But for this problem, the finance companies have little different view. They say that it is not only the economic condition of the country but it has more to do with the capacity of the lessee to perform his/her business successfully regardless of hindrances they face. To the some extent finance companies also held responsible for this problem, as the finance companies may have failed to find the credibility of the perspective client from the NRB's credit information bureau or some other financial institutions with whom the perspective has performed any sort of business.

The other problem faced is the difficulty in identification of the vehicles in case of the used vehicles. It is very difficult for the finance companies to identify the value of the asset and the condition of the asset. In such case of leasing of used vehicles, the company charges higher percentage as a down payment. This makes the lessee difficult to provide such amount, which may lead to disagreement between the two parties and may end up without signing a lease contract.

The finance company when receives the rental, it is treated as the income earned and the finance companies have to pay tax on the capital recovered also as the rental includes the portion of capital recovered and interest. This can be termed as tax loss incurred on capital recovery. The finance companies usually face heavy tax loss during the initial years and can only gain on tax in the concluding year. The tax loss may e recovered by the tax gain on depreciation of the leased asset, however, if we consider the time value of money, then the finance companies will be in loss. The prevailing rate of depreciation discourages the leasing business in Nepal.

The study has found that there has been difference in the knowledge of leasing amongst the leasing/finance companies also. Every sample organization seems to possess different knowledge of leasing and different techniques in calculating lease rental. This procedure has an adverse effect on the clients, as they were unable to decide which finance company to choose for the leasing. This may reduce the perspective client, as they may prefer borrowing instead of leasing, which will reduce the benefits that may be availed from the leasing.

Usually for any business a business-person seeks for the bigger market. Nepal being a smaller market and financial institutions are hesitating to enter the industry. But the Nepalese leasing market is not small as they has opined. This concept has prevailed in their mind since their establishment. And because not too many surveys and researches have been made in this area, finance companies are unknown of the existing prospects of investment in small-scale industries. The lack of detailed survey is what the finance companies are seeking for and they cannot do it on their own as of lack of capital to be invested in such research.

4.9 Challenges of leasing Business in Nepal

Leasing business in Nepal is in its developing stage and with that there exists many challenges. The foremost challenge is the trust or faith between the clients and the financial institutions. The financial institutions usually do not have the trust of faith on its perspective client. This problem has probably arisen due to the current economic situation of this country and this problem may continue if the economic situation of this country does not improves. Low economic conditions can lead to lower profits in the business and the lessor may hesitate to invest in the people with whom the lessors have never dealt. The probable client of the lease finance can be a juvenile but may have lots of enthusiasm to do the business, upon which the lessor does not have full trust. The lessors have trust either on the older clients or to some big business persons whom they have known to perform successful business. These lack of trust between the clients and the finance companies have been one of the important challenges of the leasing business.

Finance companies are required to keep their investment in the safe side. So it has to keep the collateral to safeguard their investment. And the clients usually have complains that the finance companies asks too much collateral. This perception should be changed as the collateral is only for the security purpose, which the client must keep with the finance company to maintain the good professional relationship. If the client opposes for the collateral, then the finance company shall have doubt on the perspective client's performance. And the lessor/finance company may hesitate to give loan or invest on lease finance.

Many a times the clients even put the finance company with questions like why there are too many clauses in the contract. It is not the interest of the finance company to put too many clauses, but the causes are there to clarify one's duties and responsibilities so that later on conflict may not arise.

There has been the concept among the lessee or clients that if they have provided the collateral more than the loan amount, then the borrower have to obey the finance companies. And if the finance company extends the loan amount without the further collateral then the finance companies have to obey its clients. This prevailing thought has led to low professional relationship between the two parties. These thoughts should be removed from the mind of general people or the perspective client in order to improve the relationship between clients and the finance companies.

There are also other practices going on unfavorable to the finance companies that the clients being bankrupt are easily allowed to start other business, getting loan from another financial institutions. This is because there is no system available to keep a track record of the borrower and these systems should be changed to keep the lease financing business safe. These types of practices can lead to mal practice by the user of the fund. Borrowers may not perform well in their business as, if their business goes wrong, then they can liquidate their business and will not be stopped from doing other business by taking loans from another financial institutions.

4.10Prospects of Leasing Business in Nepal

We have seen in the analysis that there has been not good significant growth in the leasing business and that the investment of 4 financial institutions. NSLMB and other two troubled financial institutions —

<u>Nepal Bangladesh Bank</u>, Nepal Sri Lanka Merchant Bank Ltd (NSLMBL) and NB Finance Ltd (NBFL) — are going to be merged soon. If everything goes well, the **merger** process is likely to be completed by the second week of March. Nepal Rastra Bank (NRB) has already given a green signal for the amalgamation of these three ‘technically insolvent’ financial institutions promoted by NB Group. Among them, the central bank took over the management of Nepal Bangladesh Bank on November 12 and running the bank by a NRB-assigned management team since then. “The merger process is in the final stage. So it is also discontinued the leasing business. The other two finance companies ILFC and UFCO have been discontinue the financial lease. In the begining the leasing industry of Nepal and the share of amount of lease in total credit is increasing every year. But in the latter it is fall down during the year 2004 &2005.This shows the future of the leasing business is not good.

Even the international leasing and finance company's principal activities of the Company during the fiscal year 2006/07 other than the finance lease that the company had to discontinue in the fiscal year 2006/07 due to the requirement of additional capital for conducting business.

Leasing in Nepal is being done by the provisions made under finance company rules, NRB directives, income tax act, etc. as there does not exist any specific or separate act for leasing. Finance companies are optimistic about the future of leasing business if a separate leasing act comes into existence with proper guidelines taking into considerations the problems they are now facing. So, they hope that the leasing act comes into existence as soon as possible and hopes that there will be parallel way of doing leasing business amongst the finance companies. This is also help to establish a company doing leasing business only or a leasing company as of today, the finance companies are restricted to certain amount (40% of total credit) and can freely invest in lease finance.

The risk is involved in every aspect of life and that too with the business it is inevitable. However, upon careful study analysis the problems can be reduced to minimum in order to get the mist of the business. And the finance companies are just waiting for the proper rules and regulations or the specific act to be enacted by the government to start a full fledged leading business in Nepal to benefit both the finance companies or the lesser and the lessee or the user of the leased asset and even the country as a whole.

4.11Major Findings of the Study

It is found that the leasing business is still in infancy stage in Nepal. Except finance companies no other financial institution are doing leasing business, Among 78 finance companies only four finance companies are doing leasing transaction but it is also decrease in the prior stage.

Finance company act 1986 was the first act, which had given he right only to the finance companies to do leasing business. After issuing ordinance by NRB, in 2004, the finance companies act 1986 was abolished. The new ordinance 2004 has given the right to all the financial institution to do leasing business but the paid up capital should be Rs. 15 Crore.

It is found that UFCO is the first finance company which introduced leasing business at first time in Nepal.

It is found that there is no any specific and clear legal provision, which can govern and helped to develop the leasing business in Nepal. Leasing business in mainly governed bu contract act 2001, Income tax act-2001, and ordinance issued by NRB in2004. Income tax act 2001 has defined only financial lease. According to this act lease term should be more than 75 % of the total economic life of the asset and scrap value must be less than 20% of the initial market price of the asset. Under the provision of income tax act, lessee is treated as the owner of the leased asset and the lessor is treated a the holder of debt claim against the lesse.

It is found that NRB is not playing the adequate role for promoting the leasing activities in Nepal.

Despite of two consecutive years of negative growth in lease finance, Nepalese lease finance market has growing trend.

Practice and procedures by all the finance companies is course of leasing transaction is found similar but the companies develop their own standard of lease agreement format, guiding document and policies.

Leasing business is very new to the Nepalese financial market and is only about twelve years old.

It is found that the lessor greater right than lessee. In the case of loss and damage of the leased assets, lessee is full responsible for all loss and damage. Lease requires repairing and maintenance the leased asset on his own expense and lessee should also keep the assets in good repaired condition.

The leasing company themselves determine the amount coverage and insurance and obtain insurance policy for the entire period of the lease at the company's name, but the lessee should pay the lease premium. It is found that the company requires deposits and secure the performance of lease contract.

There is no any special accounting standard specified by NRB and all the leasing companies are followed the IAS for accounting purpose.

It is found that, there is no presence of consultant services and lease broker in Nepalese leasing business.

Through the survey study, all the finance companies are convinced that leasing is not profitable business available due to the higher political, legal and credit risk. There is also a great scarce of infrastructure or promoting the leasing business in Nepal.

It has been found that ILFC and UFCO are only two finance companies having greater share in total lease finance at the prior stage but now there is also discontinue new leasing business.

Lesser has the ownership on the leased asset and the lessee has possession and uses the assets during the lease agreement period. However after the completion of the lease contract the leased asset may be transferred/ sold to the lessee at the presupposed price.

The leased asset must be maintained and repaired by the lessee.

The lessee is not allowed to use the asset beyond the lessor's working country.

The lessee bears third party liability arising from the operation of the asset.

Fundamental of leasing is to take rental in advance; it was found that NSLMB takes rental at the end of the month.

The deposit required by the NSLMB is termed as the *Down Payment*, the deposit required by the UFCO is termed as *Major Rental* and the deposit required by the ILFC is termed as *Key Money*.

CHAPTER- 5

SUMMARY, CONCLUSION AND RECOMMENDATION

This Chapter contains the summary, conclusion and recommendation.

5.1 Summary

The main objective of the study is to find the practices followed by the leasing companies regarding lease and its problems and prospects of leasing business in Nepal.

These studies comprises of identification of the history of financial institutions and the leasing business performed by the finance companies. The history of Nepalese financial institutions has been going on since the ancient time, which started with the act of giving loan to the needy people by the people who have excess money upon deposit of some collateral. This system of transaction prevailed until the government started organized business, which led to today's modern age of financial transaction through banks and finance companies. Today there are 25 commercial banks, 55 Development banks, 12 Micro-finance development banks, 16 financial cooperatives , 46 Financial NGos, 25 Insurance company and 78 financial companies performing financial transaction in Nepal. Among them only 4 finance company doing leasing business. In the survey of opinions of finance companies it is found that the infrastructures for carrying leasing business are not sufficient. Most of the finance companies think NRB has not yet made clear vision about the new provision of Rs.15 crore paid up need to conduct leasing business. They have optioned chat the current provision of Rs. 15 crore should reduce.

Due to the lack of rules and regulations in favor of leasing business these four finance companies is also discontinue and going to the process of discontinue of the transaction of leasing.

Practices And Producers followed By Leasing Companies In Course Of Leasing Business

Due to the lack of specific legal framework, it is found that there is no any specific standard to be followed in course of leasing business. In the process of lease agreement lessee makes the written application to the leasing company and the company evaluate the lessee in various grounds and after the evaluation if the company find it appropriate, written agreement is made between parties and the company finance the acquisition of assets. Lease term and rental are determined on the basis of evaluation of lessee. Lessee is fully responsible for any kind of loss and damage of leased asset. Payment of insurance premium is the obligation of lessee but it is made in the name of the company. The company can demand any kind of security and deposit in order to secure the lease contract. The Lessee cannot transfer the title of leased asset.

The sample companies have relatively similar clauses in the lease contract. The asset to be leased is determined by the lessee and the lesser usually appoints the supplier in order to protect the lassoer's interest from being deluded by the bad intension of the lessee. Each finance company requires its rental to be paid monthly and in advance except NSLMB. The lessee is required to pay the interest on any overdue amount to the lesser or the finance company. The lesser also doesn't take any responsibility regarding the guarantees provided by the supplier/manufacturer, however, the lesser may help the lessee to get his right upon submission of the written request. All the finance companies needs that the leased assets should be operated only in the area proposed and only for the task proposed. The repair and maintenance of the leased asset is to be done entirely by lease at its own expense and any part attached in the asset with the consent of the lesser, the attached part also becomes the property of the lesser. And the insurance of the leased asset is also bared by the lessee and may be paid through the lassoer's account. Upon non-performance of the clauses of the lease contract, the contract terminated and termed as default. The lessee is liable to pay all the amounts due to the lesser upon termination by default. The lessee is liable to pay all the amounts due to the lesser upon termination by default, as if any amount is due had the contract continued.

The lease rental is the integral part of the lease finance. And all the sample organization uses different ways of calculating the lease rental by using computer software of their own. The UFCO though doesn't use any additional software to calculate the lease rental. The lease rental is obtained by entering the data in the fields of the software to get the results. The schedule of payment also varies from one to another as all the finance companies uses different ways of treating the bulk amount taken at the beginning of the contract. NSLMB regards it as art of loan and deducts it from total lease finance to calculate the lease. UFCO takes the amount as the major rental, which includes the principal and the interest portion and only the principal portion is deducted to get the equal monthly rental. ILFC takes such amount as a deposit, so, it calculates rental by taking al of the cost of the assets and upon successful completion of the contract it is refunded to the lessee.

There are not any areas in the world free of problems and so do the leasing business in Nepal. The first and the prime problem is that the leasing business in Nepal till today is being performed without any specific leasing act. Due to this the finance companies have different views and ways of treating lease finance, making the clients difficult to compare and to choose between the existing finance companies. Desperate need of the leasing act has been felt to bring about the parallel way of leasing business amongst the country and to expand the business.

The other problem is the lack of capital. Huge amount is needed to expand the business or to target the large industries. Though the finance companies have entered into the leasing industry, they face different problems. The first problem is with the credibility of the lessee as finance companies struggles to find the credit history of the perspective client. They also face the problem of recovery of the rentals or with the untimely payment of the lease rentals. It is also very difficult to identify the state of the used assets to give it some standard to categorize it on the basis of good, indicative, substandard, doubtful and bad. The finance companies are struggling to enhance the features of the lease to be benefit both the parties. They are seeking for the market to invest and are destitute to have a thorough research in the lease market.

5.2 Conclusion

After the analysis of all the available facts we came to know that the Nepalese financial sector has still in infancy stage. There is increasing trend in the establishment of financial institution. However there are only four financial institutions conducting leasing business. In year 1995 there were three finance companies doing leasing business and in the interval of 10 year, only one new finance company has been added in the list. Finance Company Act 1986 was the first, which had provided the legal right to finance companies for carrying leasing business in Nepal. After the ordinance issued by NRB in 2004 the finance company act 1986 was abolished. The ordinance issue by NRB allows all the financial institutions to do leasing business but the paid up capital of these financial institutions should be Rs. 15 crore.

ILFC, LTCO and NSMB are the pioneer institutions introducing leasing business in Nepal. The share of leasing business of total loan and advance of finance companies is very low. There is no any special legal provision for conducting the leasing business in Nepal. Leasing transaction is mainly governed by contract act. Income Tax act 2001 has made the provision regarding leasing activity but it has covered only financial lease. According to the provision made by income tax act, lessee is treated as the owner of leased assets and lessor is treated as a holder of debt claim against lessee for the leased asset. It is found that all the finance companies have been using similar procedure in course of leasing business but they have developed their own standard and policy. It is found that the lessee is required to issue the certificate of acceptance after acquisition of the asset and lessee does not acquire any right, title to the asset other than stated and lessee should take care of asset. Most of the finance companies determine the lessee and they demand initial rental on the lease execution date.

Upon studying the clauses in the lease contract, it was found that the contract has kept the lesser at the safe side and free of many responsibilities. This is definitely good for the finance companies but the lessees many not benefit from those clauses.

There are few rights to the lesser and wholesome burdens of responsibilities on the part or lessee. Though the finance companies are in safe side with regard to clauses of the contract, there have been cases of loss to the lessor also and this shows the weakness of the finance companies to get the credit information of the client.

Through the study it is found that all the finance companies require certain deposit or security to secure the performance of lease agreement. Lessee has lesser right & power than the lessor, Lessee can't alter, transfer attaches, improve &pledge without prior consent of the lessor. Lessee is required to keep the asset in good condition and functioning all the respect as his own cost.

5.3 Recommendation

In the time with the major findings of he study, the following recommendations are made:

The leasing business of the finance companies is not satisfactory. This study shows fluctuating or unpredictable trend of leasing business.. Through the study it is found that government as not been playing sufficient role for promoting the leasing business. There is no any special act and legal provision mainly it is governed by contract act 2001 and income tax act 2001. Clear & adequate legal provision most important perquisite for developing leasing business, so that special legal provision is needed to develop the leasing activities in the country.

Under the provision of ordinance issued by NRB, there should be Rs. 15 crore paid up capital required to do leasing business Financial system in Nepal is still in growing stage and all financial institution, which wants to enter into leasing transaction, may not able to raise such huge capital. Therefore, 15 crore capital required for carrying leasing business should reduced.

With respect to the determinants or successful leasing business, credit assessment expense has been found as the main determinant or successful leasing business. Speed in utilization of fund comes in the second rank. Searching new market, access to cheap source of fund, providing flexibility in leasing deal come respectively in third, fourth and fifth rank as the determinant of successful leasing business.

To develop the leasing business in Nepal, the first activity should be done to increase efforts for publicity and next activity should be done to create legal framework. Subsequently, skilled manpower, provision for tax and other incentives and increment of the effectiveness of the practice are to be done.

Leasing business is new concept for Nepalese financial system so that the government should play the major role by developing the mechanism, which helps to increase the awareness for the leasing business, and government should also develop the infrastructure, which helps to promote the leasing activities around the country. The general public of this country do not have the clear concept of lese financing and its benefits. The finance companies are required to market their product in the local market so that the smallest business can also benefit by getting the desired asset leased instead of borrow. The adequate marketing of the lease is a must to increase the awareness of leasing business among general public. This would help to increase the leasing business in Nepal.

No finance companies have made a detail survey on the prospects of leasing business except some small researches about how the leasing business in Nepal are in the verge of loosing. A need of detailed study is felt very important at this situation. Such study can greatly help the finance companies to understand the weaker points to correct them and capitalize on the stronger areas. It is recommended that a finance company make a detailed study on the leasing business. Through the survey study it is found only the UFCO had conducted some programme and study about the leasing business and other companies have not done any study and programme which could help to promote the leasing activity. Without detail study and effort of financial institution it is very difficult to promote and develop the awareness of leasing business, therefore the financial institutions are recommended to conduct the require studies and programme about leasing business.

The finance companies contract bears the clauses that give more right & less responsibility to the lessor and less right & more responsibilities to the lessee. This situation of unequal right and responsibility bearing is not optimal for the development of the lease. It is recommended to finance companies to balance the rights and responsibilities.

The finance companies in Nepal are unable to create a faith with the perspective client. They only believe on the big business houses or the older clients. The finance companies should get enough credit information of the perspective or if the client is juvenile then through investigation can be made on the business proposal the perspective has presented to get its asset leased.

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Http://www.nrb.org

http://www.ilfco.com

http://www.unionfinance.org

Appendix - 1

List of Financial Institutions

As of Mid-Jan 2009

Finance Companies				
S.No.	**Names**	**Operation Date (A.D.)**	**Head Office**	**Paid up Capital** (Rs. In Million)
1	Nepal Housing Development Finance Co.Ltd.	1992/03/08	Naya Baneshwor, Kathmandu	123.6
2	Nepal Finance Co.Ltd.	1993/01/06	Kamaladi,Kathmandu	67.5
3	NIDC Capital Markets Ltd.	1993/03/11	Kamaladi, Kathmandu	101.2
4	National Finance Co.Ltd.	1993/05/07	Pako Newroad, Kathmandu	156.9
5	Annapurna Finance Co.Ltd.	1993/09/30	Chipledhunga, Pokhara	262.1
6	Nepal Share Markets and Finance Ltd.	1993/10/19	Ramshahapath, Kathmandu	432.0
7	Peoples Finance Ltd.	1993/04/15	Tripureshwor, Kathmadu	84.0
8	Mercentile Finance Co. Ltd.	1994/11/10	Birgunj, Parsa	18.0
9	Kathmandu Finance Ltd.	1994/11/10	Putalisadak, Kathmandu	75.9
10	Himalaya Finance & Savings Co.Ltd.	1993/11/11	Sundhara, Kathmandu	48.0
11	Union Finance Ltd.	12/12/1995	Ganeshwor, Kathmandu	72.5
12	Narayani Finance Ltd.	1995/03/08	Narayangadh, Chitwan	213.7
13	Gorkha Finance Ltd.	1995/03/12	Hattisar, Kathmandu	59.6

14	Paschhimanchal Finance Co.Ltd.	1995/04/09	Butawal, Rupendehi	100.0
15	Nepal Housing & Merchant Finance Co.Ltd.	1995/04/11	Dillibazar, Kathmandu	160.7
16	Universal Finance Co.Ltd.	1995/04/27	Kantipath, Kathmandu	60.2
17	Samjhana Finance Co. Ltd.	1995/05/03	Banepa, Kavre	61.7
18	Goodwill Finance Ltd.	1995/05/16	Dillibazar, Kathmandu	105.0
19	Siddhartha Finance Co. Ltd.	1995/05/25	Siddarthanagar, Rupendehi	67.7
20	Shree Investment & Finance Co. Ltd.	1995/06/01	Dillibazar, Kathmandu	100.8
21	Lumbini Finance & Leasing Co. Ltd.	1995/06/26	Thamel, Kathmandu	1200.0
22	Inbesta Finance Ltd.	1995/07/17	Birgunj, Parsa	24.0
23	Yeti Finance Co. Ltd.	1995/07/23	Hetauda, Makawanpur	62.5
24	Standard Finance Ltd.	1995/07/23	Pautalisadak, Ktm.	144.8
25	International Leasing & Finance Co. Ltd.	1995/10/31	Naya Baneshwor, Ktm.	144.0
26	Mahalaxmi Finance Co. Ltd.	1995/11/26	Birgunj, Parsa	80.0
27	Lalitpur Finance Co. Ltd.	1995/12/12	Lalitpur	75.9
28	Bhajuratna Finance & Saving Co. Ltd.	1996/01/09	Kantipath, Kathmandu	38.5
29	United Finance Ltd.	1996/1/25	Kamaladi, Kathmandu	149.8
30	General Finance Ltd.	1996/02/02	Chabahil, Kathmandu	24.2
31	Nepal Shreelanka Merchant Bank Ltd.	1996/02/04	Kamaladi, Kathmandu	100.0
32	Merchant Finance Co. Ltd.	1996/01/02	Kathmandu	33.4
33	Alpic Everest Finance Ltd.	1996/07/16	Baghbazar, Kathmandu	78.0

34	Nava Durga Finance Co.Ltd.	1997/02/09	Itachhe, Bhaktapur	45.6
35	Janaki Finance Ltd.	1997/03/07	Janakpurdham, Dhanusha	40.0
36	Pokhara Finance Ltd.	1997/03/16	Pokhara, Kaski	60.0
37	Central Finance Co. Ltd.	1997/04/14	Kupondole, Lalitpur	72.0
38	Premier Finance Co. Ltd.	1997/05/08	Manbhavan, Lalitpur	28.8
39	Arun Finance & Saving Co. Ltd.	1997/08/17	Dharan, Sunsari	11.0
40	Multipurpose Finance Co. Ltd	1998/3/25	RajbiRaj, Saptari	3.0
41	Butwal Finance Co. Ltd.	1998/06/21	Butawal, Rupendehi	82.7
42	Shrijana Finance Ltd.	1999/12/14	RajbiRaj, Saptari	14.0
43	Om Finance Ltd.	2000/09/17	Pokhara, Kaski	84.0
44	Cosmic Merchant Banking & Finance Ltd.	2000/11/20	Lal Durbar Marg, Ktm.	75.1
45	World Merchant Banking & Finance Ltd.	2001/08/10	Hetauda, Makawanpur	72.0
46	Capital Merchant Banking & Finance Ltd.	2002/02/01	Battisputali, Kathmandu	346.2
47	Crystal Finance Ltd.	2002/02/13	Bag Durbar, Kathmandu	49.0
48	Royal Merchant Banking & Finance Ltd.	2002/02/14	Durbarmarg, Kathmandu	134.3
49	Guheshworil Merchant Banking & Finance Ltd.	2002/06/13	Jawalakel, Lalitpur	109.8
50	Patan Finance Ltd.	6/23/2002	Man Bhawan, Lalitpur	50.0
51	Kist Merchant Banking & Finance Ltd.	2003/02/21	Kamalpokhari, Kathmandu	2000.0
52	Fewa Finance Ltd.	2003/04/30	Pokhara, Kaski	91.0
53	Everest Finance Co. Ltd.	2003/07/02	Bhairahawa, Rupendehi	20.0

54	Birgunj Finance Ltd.	9/28/2003	Birgunj, Parsa	85.3
55	Prudential Bittiya Sanstha Ltd	2003/06/06	Dillibazar, Kathmandu	100.0
56	ICFC Bittiya Shanstha Ltd.	2003/06/15	Bhatbhateni, Kathmandu	299.4
57	IME Financial Institution Ltd.	2005/08/01	Kantipath, Kathmandu	125.0
58	Sagarmatha Merchant Banking and Finance Co. Ltd	2005/08/29	Maanvawan,Lalitpur	50.0
59	Shikhar Bittya Sanstha Ltd.	2005/09/15	Thapathali,Kathmandu	50.0
60	Civil Merchant Bittiya sanstha Ltd.	2005/09/18	Kuleshwor,Kathmandu	80.0
61	Prabhu Finance Co. Ltd.	2006/02/16	Kantipath,Kathmandu	160.0
62	Imperial Financial Institution Ltd.	2006/03/08	Putalisadak,Kathmandu	50.0
63	Kuber Merchant Bittiya sanstha Ltd.	2006/03/24	Putalisadak,Kathmandu	50.0
64	Nepal Express Finance Ltd.	2006/05/04	Butawal, Rupendehi	80.0
65	Valley Finance Ltd.	2006/05/11	Maharajganj,Kathmandu	27.5
66	Seti Bittiya sanstha Ltd.	2006/06/07	Tikapur, Kailali	5.2
67	Hama Financial Institution Ltd.	2006/06/16	Tripureshwor, Kathmandu	31.5
68	Reliable Investment Bittiya sanstha Ltd.	2006/09/06	Sundhara, Kathmandu	82.5
69	Loard Buddha Financial Institutions Ltd.	2006/11/19	Newroad, Kathmandu	51.6
70	Api financial Institution Ltd.	2007/4/25	Lekhanath Chock, Kaski	42.0
71	Nameste Bitiya Sanstha Limited.	2007/07/07	Ghorai, Dang	10.1
72	Kaski Finance Limited	2007/7/30	Pokhara, Kaski	50.0

73	Suryadarshan Financial Institution Ltd.	2007/7/30	Baneshor, Kathmandu	30.0
74	Zenieth Merchant Financial Institution Ltd.	2007/10/08	Newroad, Kathmandu	63.0
75	Unique Financial Institution Ltd.	2007/10/12	Putalisadak, Kathmandu	30.0
76	Manjushree Financial Institution Ltd.	2007/10/15	New Baneshor, Kathmandu	70.0
77	Swostik Merchant Finance Company Ltd.	2007/10/16	Kichapokhari, Kathmandu	31.8
78	Subhalaxmi Finance Ltd.	2007/11/11	Naxal, Kathmandu	70.0

Source: www. nrb.org.np

Appendix - 2

Introductin of "International leasing and Finance Company LTD."

The International Leasing and Finance Company Ltd. is one of the finance company among the 48 finance companies in Nepal and it has been successful in maintaining a different status compared to other companies. The most significant feature of ILFC lies is the fact hat it is the first joint venture company established to promote the relationship between Nepal and Korea.

The Asian Development Bank and National Life and General Insurance Company Ltd., the major Nepalese Promoters, initiated this project to widen the scope of Nepalese financial activities. In order to introduce lese finance in Nepal ADB provided technical assistance to carryout feasibility study of this project and invited the Korea Industrial Leasing Company Ltd. To participate in this project as a foreign Partner and manage the company. On 11th December 1994, ILFC evolved with its objective to introduce and promote the fast growing innovative concept of investment in "Leasing Business" exclusively in Nepal. With the constant mutual efforts of Nepalese and Korean Counterparts, the corporate entity of ILFC emerged as the first joint venture finance company between Nepal and Korea. ILFC was registered in the Company Registrar Office on 11th December 1994 and obtained the business-operating license from the Central Bank of Nepal on 18th September 1995. Since then ILFC has been continuously rendering variety of financial services according to the aspirations of the Nepalese people.

On 2nd March 1999, another historical event took place in the corporate structure of ILFC. KDB Capital Corporation came up as the foreign partner of ILFC replacing the KILC after the merger of KILC with KTFC. This merger turned the parent company of ILFC to stand not only as one among the top largest Leasing Companies in Asia but also as a strong player in the venture capital market. Now, ILFC is on the verge of Finance Corporation, a subsidiary of World Bank Group and one of the largest and renowned financial institutions in the world. Besides, the deep faith of Nepalese People on ILFC has enabled the Company to stand as the most reliable and professional financial institution in the Nepalese financial in the Nepalese financial market.

Appendix - 3

Introduction of Union Finance Company LTD.

Union Finance company (UFCO) is the first non-banking financial institution to introduce the leasing business in Nepal. It was established in 1993 in technical collaboration with BAIL EQUIPMENT of UECCI of FRANCE whose leasing expertise is widely recognized throughout France.

UFCO was recognized with the Company Registrar Office on 25th March 19993. Its operation came into effect on 12th December 1994 after obtaining the license on 17th September 1994 from Nepal Rastra Bank.

Since its operation, UFCO has been providing financial services successfully to individuals, business enterprises within the Kathmandu valley and other parts of the country in the form of taking deposits, lease financing, land and financial guarantees.

The company has maintained professional standards and transparency in all its dealing with customers' and authorities. The company has followed an open and fair recruitment policy to recruit staff members.

Despite the economic constraints and limited investment avenues the objective of UFCO to extend financial services throughout the Democratic Republic of Nepal will continue. The companies' future endeavor in upgrading financial services involves investment in projects and industries as well.

Appendix - 4

Introduction of "Nepal Sri Lanka Merchant Bank"

Nepal Sri Lanka Merchant Bank initially was established as joint venture Merchant Bank with the Merchant Bank of Sri Lanka Ltd. (MBSL) and the NB Group (Nepal) Pvt. Ltd. The company was incorporated on 15 the August 1994 and commenced its operation on 4th February 1996. Within a short time span of approximately 3 months, in May 1996, the Central Bank of Nepal, Nepal Rastra Bank, recognizing the company as a truly dedicated Merchant Bank granted blanket approval to perform all Merchant banking activities subject to clearance from Stock Exchange authorities to perform functions relating to Capital markets.

NSLMB was managed by MBSL under a Management and Technical Services Agreement between the MBSL that had a strong support form its parent Bank, bank of Ceylon. Currently the company is managed by Nepalese professionals and under Nepalese Management.

NSLMB with all clearance from His majesty's Government of Nepal (HMG/N) to perform Merchant Banking Services is the first of its kind to offer its clients the financial tools international businessmen se to chart their path to success. Corporate Counseling, Project Counseling, Capital and Management Restructuring, Venture Capital, Equity and Debt Syndication, Initial Public Offering, Private Placements, Fund Management, Margin Trading, Privatization, Working Capital Financing, Lease Financing, Mergers and Acquisitions, Offshore Financing and Negotiable instruments are some of the unique products NSLMB offers as the Business Bank, advisor, friend and partner in progress of their client. The primary asset of the NSLMB is financial intelligence and its primary role is sound financial and business advice.

In an environment where the future is unfolding everyday, which is apparent everywhere in the world with corporations restructuring to compete more aggressively in the global environment, and with the dawn of Nepal's new political and economic era, NSLMB does more than just watch these and other powerful forces of change throughout the world affect Nepal. NSLMB help people understand the impact of these forces of change throughout the world affect Nepal. NSLMB help people understand the impact of these forces in their lives, insights that help the country, companies and individuals shape a better future.

At a time when HMG/N is making major policy commitments for economic liberalization NSLMB as Merchant Bank plays an important role in directing savings of the public towards economic development of the country. NSLMB guide the wider sections of the community possessing surplus money to invest in corporate securities and other productive investment channels. NSLMB device new instruments to finance industrial project and assume wider responsibility to guide industrial units and prevent them becoming sick. NSLMB will continuously harness the entrepreneurial skills of the community through access to investment and credit finance.

Appendix - 5

Growth Trend on Lease Finance in Nepal

Year	Loan and advance in Lease	X(n-2003)	x2	XY	Trend value YC=a+bx
2001	277.8	-2	4	-555.6	193.46
2002	363.6	-1	1	-363.1	229.26
2003	148.8	0	0	0	265.06
2004	287.9	1	1	287.9	300.86
2005	247.2	2	4	988.8	336.66
N=5	∑Y=1325.3	0	10	∑xy= 358	

$$a = \frac{\sum Y}{N} = \frac{1325.3}{5} = 265.06$$

$$b = \frac{\sum XY}{\sum x2} = \frac{358}{10} = 35.8$$

Future forecasted Trend in growth of lease finance

Year	X(x-2003)	Y=a+bx
2006	3	372.46
2007	4	408.26
2008	5	444.06
2009	6	479.86
2010	7	515.66