LEASING AS A METHOD OF INVESTMENT FINANCING

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Abstract

Constant searching for new forms and new ways in financial construction, investments, searching new sources for their realization, as well as permanent tendency of economic entities to join the latest trends of technical and technological development, have resulted in the creation of a new method for investment financing, which is, in international business practice, known as „leasing". Leasing is not a physical event, but a business and financial engagement. Leasing is a new method of investment financing, which is made in business practice. Leasing, as a defined business activity, appears in the 50s of the 20th century in the USA, as a product of the tendency to bridge the gap between the need to use the appropriate funds and the lack of conditions to obtain these funds under the usual commercial conditions. The mentioned gap could be overcome only by innovative approach, which involves the agent who owns those funds and has a combination of financing. After the initial conditions in the USA, leasing began to spread in Europe, where it provided the significant contributions to the development of economy, primarily due to the easiness and simplicity of financing.

Key words: leasing, investment financing.

INTRODUCTION

Today, leasing is generally accepted modern method of financing the investments in the world. In the 80s of the 20th century in the USA, according to the assessments, there was a turnover in this business of more than 150 billion of USD. In addition, it is estimated that in developed countries, today, there is more than 30% of investment equipment engaged on the basis of leasing. In modern international practice, the leasing jobs are applied in various fields. There are three groups:

1. The first group includes the nondurable goods (means of transport, computers, processors, TV devices, office equipment, entire manufacturing equipment, medical equipment, household utensils).
2. The second group includes the investment equipment in the broadest sense, which can be also combined with different types of technical assistance, such as equipment maintenance, personnel training.
3. The third group includes the leasing of used items.

Today, leasing is a very widespread occurrence of the proved effects, and it is offered to transition countries as a significant relief in financing the procurement of investment equipment. In those countries, the capital is the most deficient factor and leasing significantly contributes to overcoming that deficiency. Leasing is a financial transaction with the elements of the lease. The essence of lease is the connection between lease and financing. Leasing cannot be identified either with lease or with buying and selling. In case of the lease, the lessor does not deprive himself of the leased item after the expiry of the lease, which does not have to be the case with leasing. In case of buying and selling, at the very beginning, there is a transfer of ownership to the user, which does not have to be the case with leasing.

One of the main characteristics of equipment leasing in the traffic is that, in the period of leasing, the equipment leased is owned by the lessor and that during or in the end of agreed term for the leasing, the lessee can:

1. return the equipment leased to the lessor,
2. keep the equipment leased in permanent ownership,
3. renew the lease.

The most important obligation of the lessee is to pay the lessor, in the agreed leasing period, the fee in terms and in a way that is anticipated by the lease agreement. According to the common terminology, leasing implies the medium-term and long-term lease, as opposed to „rental" or „renting" as short-term leases. It is believed that short-term lease can be up to 3 years, medium-term lease from 3-7 years and long-term more than 7 years.

The lessees have two options to acquire the equipment through leasing:

1. directly with the equipment manufacturer, who is, at the same time, the deliverer of leasing items and lessor (direct leasing),
2. through specialized companies, which buy out the leasing item from the deliverer of leasing items, and then, as lessors, they finance the entire leasing (indirect leasing).

The second model is by far more widespread in the world.

Depending on the jobs they deal with, there are several types of leasing companies:

1. financial leasing companies – they exclusively deal with the financial aspect of leasing; at the lessee's request, they purchase the leasing item from the deliverer and have it leased on the basis of the agreement, which obliges the lessee to assume the concerns linked to the ownership,
2. specialized leasing companies – provide the services of non-financial character, such as maintenance, repair of the leased items, personnel training,
3. brokerage leasing companies – whose task is to connect the lessor and lessee when negotiating,
4. branches of the leasing companies – which are usually formed of equipment manufacturers in the form of younger companies.

1. TYPES OF LEASING

With the development of leasing operations and expansion of the sphere of its application, various forms of leasing were developed in order to satisfy the specific and various requirements of the lessees. In the modern practice of equipment leasing, numerous forms with specific names and essential characteristics are applied.

According to the status of the lessor, there are two types of leasing:

1. direct leasing – when the lessor is simultaneously the deliverer of the leasing item (equipment manufacturer) and leasing financier;
2. indirect leasing – when the lessor is a leasing company, which purchases the item (equipment) from the deliverer (manufacturer), at the requirement of the lessee (user of the leasing) and leases the same under particular conditions.

We distinguish:

a) Operating leasing

This type of leasing has the contractual life that is shorter than economic. Service costs belong to the lessor and they are included in agreed price of the leasing. Present value of leasing payment is less than the current value of the leasing item. After the expiry of the agreed lease, the asset is returned to the lessor or it is given to the new lessee. The lessee can use the period of notice, when he finds it necessary, while the lessor still owns the leasing item, and all the risks of technical and technological obsolescence will be borne by the lessor.

b) Finance (capital) leasing

In case of this type of leasing, the lessee cannot cancel the lease contract in the agreed period, while the lessor can do it if the lessee fails to comply with contractual obligations. As we have mentioned before, the lessor does not provide any other services except financing the leasing, and thus, the lessor tends to transfer the ownership of the leasing item onto the lessee after the agreed period expires. Leasing lasts almost as the economic life of the leasing item does. The current value of the leasing covers the costs of the assets. Insurance and tax costs are always, as a rule, transferred onto the lessee by the lessor.

According to the length leasing period, we distinguish:

1. short-term leasing – with the agreed term of up to 3 years,
2. medium-term leasing – with the agreed term from 3 to 7 years,
3. long-term leasing – with the agreed term of more than 7 years.

According to the type of contractual obligations after the leasing period expires, we differ:

1. "Term Leasing" – when the leasing term is precisely defined and, after the expiration, the leasing item is returned to the lessor,

2. "Leasing with Option to Purchase" – when it is explicitly agreed that the leasing item will be purchased by the lessee, during or at the end of the leasing period,

3. "Revolving Leasing" – when it is expressly determined, by the leasing agreement, that the leasing will be renewed after the agreed leasing period expires.

According to the type of equipment, which is the item of the leasing, we distinguish:

1. Individual equipment leasing,
2. Complete plants leasing,
3. Parts of the enterprise leasing and
4. Entire enterprise leasing.

According to the type and scope of contractual obligations in the aspect of maintaining the leasing equipment in the agreed period, we distinguish:

1. "Brut Leasing" – when the lessor undertakes the insurance of the leasing items during the leasing, maintaining the same and training the personnel of the lessee, whereas the lessee, by the contract, assumes the obligation to pay a certain fee to the lessor,

2. "Net Leasing" – when the lessor, by the leasing agreement, does not assume any obligations in the insurance of the leasing items, maintaining and personnel training.

2. ECONOMIC CHARACTERISTICS OF THE LEASING

A series of circumstances and economic factors have influenced the strong development of leasing operations in the world. Simultaneously with the increase of the scope of leasing operations, the sphere of their application was expanding. Especially the leasing of industrial equipment was rapidly developed. In the global economy, what is becoming increasingly dominant is the view that ownership is not basic and most important category of modern production and trade, but that the state of legal possibilities of using the investment goods is of much greater importance.

The concept of leasing is based on the separation of the term property from the term use, giving the advantage to the use of goods. This is expressed in cases of acquiring the expensive investment equipment, which, as a rule, rapidly becomes obsolete in technical and technological sense, where the management of the enterprise is faced with the decision to significantly block a large amount of financial assets in one moment, by the loans and credits, which are extremely expensive sources of financing, and this represents a blow for the liquidity of enterprise. For that reason, the companies that do not have enough financial capacity to purchase fixed assets in the long-term period should be directed to leasing, because the burden of financing the fixed asset, acquired through leasing, is considerably less in the first years of the agreed life than it is in case of purchasing. By deciding to acquire the assets through leasing, the management of the enterprise chooses the alternative that is less demanding and that allows them to live with less financial outflows. Such financial option provides so-called off-balance sheet financing, because no long-term obligation is shown in the balance sheet and it provides the appearance of a financially sound and liquid enterprise. From the above-mentioned, it can be seen that the issue of the impact, which the leasing has on debt capacity of the enterprise, remains open.

Financial performances of the enterprise are the statements that are based on the relationship between inputs and outputs (investments and effects). Supply of the capital engaged is taken as the investment, and profit is taken as the result.

Common terms of profitability:

1. Return on total capital engaged – in which case, there is no capital engaged for equipment that is used and that is obtained through leasing and, for that reason, it is not shown as invested capital in the income statement, which results in the reduction of capital supply with the same profit supply and it provides a higher profit rate and

2. Net cash inflow at certain periods – in this case, in the first years of leasing, the cash outflow is considerably less than it would be if the equipment was purchased, which provides a higher net cash inflow for the result.

The costs of acquiring the equipment through leasing consist of primary and secondary costs. Primary costs are contained in leasing fee, which the lessee pays to the lessor, on the basis of the use of leasing item, during the agreed leasing term.

Secondary costs, which are, as a rule, paid by the lessee, are:

- Costs of transport and installation of the leased item,
- Costs of insurance of the leased item,
- Costs of maintenance and servicing of the leased item.

The majority of secondary costs are not included in leasing amount, but they are paid separately by the lessee. Primary leasing costs are expressed through the leasing fee, i.e. the structure of leasing fee and height of the costs that are, in the normal conditions, included in the amount of leasing fee. It means that there is no single tariff of the leasing, for the same type of leasing item, the same leasing term and at the same or similar refinancing conditions, the amounts of leasing are different in most cases. For the lessee, it is very important to know the structure of costs that are included in leasing fee, so that he could relevantly negotiate with lessors on the conditions of the offered leasing and to achieve the most favorable leasing price in the end.

Leasing fee represents a fee for using the leasing item, which the lessee pays to the lessor. In leasing jobs, the lessor undertakes:

1. The function of financing, because he purchases the leasing item from the deliverer and pays him for the same, and returns the invested funds through a longer period (in case of indirect leasing), while in case of direct leasing, the lessor is also, at the same time, the deliverer of the leasing item (equipment manufacturer), who has his equipment leased and the same returns to him through a longer period;
2. The risks such as:
   - Risk of financing,
   - Risk of currency changes,
   - Risk of technical and technological obsolescence of the leasing items,
   - Risk of damage or loss of leasing items,
   - Risk of premature termination of the leasing agreement etc.

The lessor includes all the costs in leasing fee, which he transfers to the lessee by the leasing agreement as a payment obligation. The structure of leasing fee consists of the depreciation costs, which in the agreed leasing period should, completely or by a part, offset the purchase price of the leasing item, as well as all the other costs of the lessor, which originate from performing particular functions and assuming certain risks.

Basic components of the costs that are not included in the leasing fee are:

1. Depreciation costs – leasing period cannot be longer than the period of depreciation of leasing items. The lessor calculates the depreciation costs in such a way that they, in the agreed leasing term, completely cover the purchase price of the leasing item.
2. Primary and secondary costs of financing – depend on the conditions under which leasing companies are refinanced at the appropriate institutions, i.e. the conditions under which the deliverer of leasing item, who is also the lessor at the same time, sells the undue claims to the corresponding financial institutions. on the basis of the leasing.
3. Premiums for risks and self-insurance – in each case, the lessor estimates the degree of certain risks on the basis of the relevant elements, such as: solvency of the lessee, type and extent of bank guarantee. The lessor transfers these costs to the lessee.
4. Tax liabilities that are paid by the lessor – according to tax regulations of most countries, the lessor is a tax payer obliged to pay certain taxes, on the basis of leasing the items, which are his property. The lessor also transfers these obligations to the lessee by the leasing agreement.
5. Costs for performing various activities – if the lessor has agreed by the leasing agreement to provide material services for

the lessee, he transfers the same as payment obligation of lessee, especially apart from the leasing fee, which is the most frequent case in business practice.

6. Profit of the lessor – expressed in gross amount and included in leasing fee, and it can also be separately expressed in the form of commission for leasing organization.

The lessor has the ultimate objective to completely cover the purchase price of the leasing item in the agreed leasing term, regardless of it length.

When choosing the way to finance the procurement, the circumstances such as the level of own funds engagement in procurement realization, dynamics of the cash flow of the funds in the period of economic use of equipment, keeping own funds, actualization and inflation factors, which have long-term effects for the funds engaged for paying the procurement costs, are significant.

In terms of shortage of the quality funds for financing the investments and limited financing sources, leasing was approached to as one possibility that i left, in the lack of other sources of financing.

When deciding whether the necessary equipment needs to be obtained by purchase or through leasing, the following elements need to be analyzed:

- Procurement costs – comparing the procurement costs in case of purchase by own funds, purchase by loans and in case of leasing, we come to the results that the costs of procurement through leasing are significantly higher than the costs for purchase by own funds, as well as that they are higher costs of purchase by loans;
- Outflow dynamic of cash funds – leasing, as a rule, has a smaller outflow of the cash funds in relation to the purchase by own funds, as well as the purchase by loans. That enables the lessee to keep the quality cash funds and to place them to other business transactions.
- Projection of the profit – it is done on the basis of predicting the profit, which the lessee will provide by placing the funds, which he preserved by leasing the equipment.

Leasing provides for the investment costs to be converted to the operating costs. Whether to buy the equipment and pay in advance, before it is productively used, or to obtain the equipment through leasing and make the profit by its use and pay the lease costs from that profit. By obtaining the equipment through leasing, the lessee provides a more balanced cash outflow, especially in the first years of using the leased equipment, which results in keeping own funds that can be placed in other business transactions for acquiring the appropriate profit.

Leasing, as a modern method of financing the procurements, can be applied only by those economic entities that operate well and show the high level of business dynamism. Only by efficient and intensive exploitation of leasing items, i.e. successful realization of the goods produced by leased equipment, as well as favorable placement of the funds that are preserved due to leasing, we can promptly pay relatively high leasing costs and use the significant effects, which this financial method in the whole provides.

In order to estimate the usefulness of leasing implementation, it is necessary to calculate the possible gain from preserved and placed cash funds. These funds can be placed by:

- Investing in fixed assets,
- Investing in working capital of the lessee,
- Investing in another business transaction.

The difference between leasing and purchase of capital goods is in the engagement of the funds. in case of purchasing, the buyer engages the funds in advance and pays for the equipment when it i still not inserted to the drive – used, while in case of leasing, the leasing fee burdens the operating costs and it is paid from the total income, in which the leased equipment also has its share. By the procurement of capital goods through leasing, the lessee is not limited by anything in the aspect of choosing the leasing item, and very frequent case is, when purchasing the capital goods by funds of foreign loan, that the lender conditions the use of loan by purchasing

the equipment in a particular country and from the particular manufacturer.

By purchasing the capital goods through leasing, the lessee (user) does not impair his solvency, and that is because the leasing in not, by its essence, a loan, but it represents an independent source of financing, while by purchasing the capital goods by loan, the user reduces his solvency for the amount of the loan taken.

Leasing is extremely flexible model of financing. Flexibility of leasing in relation to the other models of financing the procurements is expressed in the aspect of paying the leasing fee, which is, as we have already stated, very important for the lessee from the aspect of cash.

Paying the leasing fee can be arranged in several ways:

- „linear leasing" – when negotiating on the leasing payments in equal amounts, for the duration of the lease;
- „accelerated leasing" – when the agreed payments are higher in the beginning of leasing, and later they become smaller;
- „slow leasing" – when the payments, smaller in the beginning of leasing and higher later on, are determined by the agreement.

In case of „linear leasing“, the leasing fee payments in equal periods, at the set intervals (monthly, quarterly, semiannually) for the leasing duration, are negotiated on. By this, the uniform outflow of the funds for the duration of leasing is achieved. The lessee is enabled to balance the ratio of leasing costs and inflow of the funds acquired by realization of the goods manufactured with leasing item. In the aspect of complying the leasing costs and inflow of the funds, realized on the basis of using the leasing item, and even better effect is achieved by applying the „slow leasing“, in which case the leasing payments are arranged to be the lowest in the beginning of leasing and to increase later on during the leasing.

In most cases, the extent of equipment use, as the leasing item, is the worse in the initial phase of exploitation (run-in, probation). In addition, in that phase of realization of the goods placement, which was manufactured by leasing item, i.e. the inflow of funds on that basis is, as a rule, significantly slower in the particular period. Therefore, it is very important for the lessee to provide the minimum leasing costs in the initial exploitation phase and, for that reason, the best effects are provided by „slow leasing“ in this aspect. From the above mentioned, it can be seen that leasing provides extraordinary possibilities in relation to other methods of financing the procurement, that the lessee (user) can comply the dynamics of paying the leasing fee with the expected inflow of the funds on the basis of placing the goods manufactured by leasing item (equipment).

3. LEASING LEGISLATION

Legal legislation that follows the leasing is based on the principles of liberalization and deregularization and provides significantly bigger possibilities for wider use of leasing. For very short time, under the influence of practice requirements, legal legislation has begun its expansion. For the realization of leasing, the following four laws are important:

1. Law on Financial Leasing,
2. Customs Law of the Republic of Serbia,
3. Law on Foreign Trade and
4. Law of Obligations.

The Law on Financial Leasing defines the four basic legal institutes:

a) financial leasing transaction

It involves three parties: Lessor, Lessee and Deliverer of the leasing item. All the three parties sign the agreements, on whose basis the lessor acquires the ownership right of the leasing item, according to the specification of the lessee and under the conditions which are approved by the lessee, while on the other hand, he signs the agreement on financial leasing with the lessee, and that agreements obliges him to transfer the authorization for keeping and using the leasing item for the agreed time to the lessee, and the lessee is obliged to pay the agreed fee for that, in the agreed installments. As it can be seen, it comes to the business arrangement, which implies the signing of two separate contracts: purchase contract and contract on financial leasing, which are mutually connected and make a whole.

The Law stipulates that minimum term for the leasing contract cannot be less than two years from the day of signing the contract. In addition, the mentioned Law defines that the leasing item can only be a mobile nondurable item (equipment, plants etc), while the real estate, due to the specificity of their proprietary regime and nature of financial risk, are not the matter of this law.

The lessee is obliged to inform the deliverer of the leasing item that he acquires the item in order to execute the agreement on leasing and to specify the person that is the lessee in that agreement.

b) Financial Leasing Agreement

Significant elements of this agreement are the following:

- Precise determination of the leasing item,
- The amount of the fee, which the lessee pays,
- Number of installments and time for paying the fee,
- Time for which the contract is concluded.

In addition, the agreement may also have the other elements, such as:

- Place, time and manner of delivering the leasing item,
- Ownership of the leasing item,
- Party that is obliged to provide the insurance of the leasing item as well as
- The risks against which it should be insured,
- The way of terminating the agreement,
- Option of purchase or renewal of the agreement,
- Costs of transportation of the leasing item, as well as installing and uninstalling and
- Current maintenance, replacement of parts, servicing,
- Training the personnel of the lessee for the use of the leasing item.

Agreement on leasing is always concluded in the written form. The law specifically stipulates that the agreements on leasing, which are concluded in accordance with this law, are considered as the agreements in the field of economy, in the sense of provisions of the Law of Obligations, except the case when the lessee is a physical entity that does not perform the registered activity for acquiring gain.

Basic reasons that lead to the termination of the agreement on leasing are:

- Expiry of the period stated in the agreement,
- Destruction of the leasing item due to the superior force,
- Non-compliance with the agreed payment of installations and delay in the payments,
- When the right of purchasing the leasing item is transferred to the lessee by the agreement.

c) subjects of the financial leasing and their rights and obligations

The subjects in the financial leasing are:

- Lessor,
- Lessee and
- Deliverer of the leasing item.

The lessor is a company that performs the jobs of financial leasing in accordance with the legislation of the state in which it was founded, whose minimum part of the fixed capital, paid in cash, is 100.000 €. This amount of the minimum of fixed capital is given for the protection of the lessee, because this field is extremely susceptible to high risks.

The lessee is legal or physical entity, to which the lessor transfers the right of keeping and using the leasing item, with the agreed fee and in the agreed period.

The deliverer of the leasing item is legal or physical entity, which transfers the ownership right of the leasing item to the lessor in order to give it to the lessee for keeping and use, with the agreed fee and in the agreed period.

Rights and obligations of the Lessor are regulated in the following fields:

- Acquisition of the leasing item,
- In case of bankruptcy of the lessee,
- In case of exclusion of the responsibility for the damage caused by the leasing item,
- Right to terminate the agreement due to non-payment of the lease and responsibility for legal defects.

The responsibility of the Lessor for the deficiencies of the leasing item was especially emphasized, because the lessor is in the position of the owner.

The Lessor is responsible if there is a right of the third party on the leasing item, which excludes or limits the keeping of the item by Lessor, and of whose existence the Lessor is not informed, nor has he given the consent to accept the item with that condition.

It is important to point out the possibility to the Lessor that, in case of agreement termination, he can rapidly and efficiently recover the leasing item. The Lessor can acquire that right through the dispute in the competent court, with the obligation of a faster procedure and in accordance with the provisions of the Law on Execution Procedure. In addition, this Law defines the rights of the Lessor for the compensation of the damages that occur due to the non-payment of the leasing fee due to the damage of the leasing item.

Rights and obligations of the Lessee, in accordance with the Law, are the following:

- Obligation to take over the leasing item,
- Right to terminate the agreement due to material deficiencies or non-delivery,
- Obligation to use the leasing item with the attention of a good host,
- Maintenance of the leasing item in good condition,
- Payment of the leasing fee in accordance with the provisions of the agreement,
- Taking the risk for damaging leasing item,
- Obligation to return the leasing item,
- Insurance obligation,
- Possibility of giving the leasing item to someone else for using.

Rights and obligations of the Deliverer of the leasing item are the following:

- Obligation to deliver the leasing item to the Lessee in good condition,
- Obligation to deliver the leasing item to the Lessee at the time and in the place specified in the agreement on delivery,
- Rights in relation to the alteration of the agreement on delivery.

The Deliverer of the leasing item is not a party to the contract in the agreement on financial leasing, but he has certain obligations and responsibilities, based on the agreement and law.

d) Register of the financial leasing

Register of the financial leasing is a public registry, in which we enter the data on leasing agreements, signed between physical and legal entities. In addition, to this register are also entered all the modifications and amendments of the leasing agreement, as well as its termination. The subject of registration may also be the note that there is a dispute in relation to the leasing item and that by the requirement of one of the parties of financial leasing. Deadline for registering is 7 days from signing the leasing agreement, its modifications, amendments and termination. This is an obligation of the Lessor, unless it is not transferred to the Lessee by the leasing agreement. Data that are entered and kept in the register are public. Register of the financial leasing has to be available to all the entities, regardless of the location and territory in which the access to the register is performed, so that they could register the contract of search for it. Local units of the register are formed in the territory of the Republic. Subjects of the leasing can require for the note on dispute existence to be entered, which refers to the leasing item. It needs to be emphasized that the data entered to the register are not the proof of the existence of ownership or other rights on the leasing item. Register of the financial leasing was supposed to function since 01.01.2004.

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