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Profitability Analysis and Financial Evaluation of Select Leasing Company in India

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Abstract: Leasing is a prospective financial device that facilitates admittance to refined technology and has played a central role in capital formation. It has evolved as a serve for fundamental reformation of Indian financial system by replacing conventional sources of long term finance. This paper provides a comprehensive coverage of leasing and is well supported by research data collected from varied sources. This study examines the lease financing practices in India and profitability analysis and financial evaluation of Sundaram Finance ltd (SFL). The financial statements of SFL for ten year period (2005-2014) were analysed. The ratio analysis technique is appropriately used to evaluate the liquidity, solvency and turnover of the company. Main objective of the study is to evaluate the overall performance of the company. Study is purely based on secondary data obtained from published annual reports of the company. Last of all, based on the conclusion of the study, appropriate suggestions are made for sustainable and sturdy expansion of the leasing industry.

Key words: Leasing · SFL · Finance · Liquidity · Solvency

INTRODUCTION

In a developing country like India, where capital is scarce, obtaining the required finance has always been a difficult task for business enterprises. This has necessitated a continuous search for convenient sources of finance

Modern business environment is becoming complex. The objective of business firms is to achieve growth with stability. To accomplish such an objective, these firms are required to go for massive expansion, diversification and modernization. Essentially, such projects involve huge amount of capital investment. High rate of inflation, escalation of cost, heavy taxation, diseconomies of operation, increasing of technological obsolescence and meagre internal resources have forced many companies to look for the alternative means of financing [1]. Due to obvious reasons, leasing has emerged as a new source of financing. Leasing has been contributing significantly to the capital formation in developed and developing countries. The reduction in hire purchase volume forced Prominent HP companies to add leasing as an additional activity [2].

International Accounting Standard (IAS) 17, Leases, prescribes the accounting treatment of leasing. A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time [3].

In India, 'The First Leasing Company' was started in 1973. The year 1989 proved to be the decade of the internationalization of equipment leasing. The leading leasing companies foresee the need for an organization and formed the 'Asian Leasing Association' (Asia Lease) in 1982 [4].

As per the Global Leasing Report, presented by the London Financial group it reveals that there is a significant growth in Leasing Industry world wide. In the year 1978 leasing business was of $ 40.8 billions. Then the Volume of the Business increased tremendously to $273.8 billions in 1988. Within a decade i.e., in the year 1998 it reached to $432.5 billions. The leasing volume in 2011 was $616.83 billions showing a tremendous growth in leasing industry. Through out the period there was a significant growth found in this industry. Remarkable growth is found due to contribution from the U.S based companies their contribution is $193.9 billions as highest of all countries in the world. Where as other developed countries like China contribution $63.72 billions, next Germany $52.49 billions. Where as India's contribution is insignificant and negligible at $1.05 billions [5].

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In India, the leasing business is progressing slowly, in terms of volume and also in terms of varieties of transactions. Hence there is need to conduct a study to identify the areas in which it can be developed.

There is a tremendous potential for leasing in India. Hence the Government of India and State Governments have to encourage the companies, financial institutions and banks to develop the industry. They should also liberalize the rules, terms and conditions by Reserve Bank of India.

Leasing Volume by region (1991-2010) US$bn

Year	Europe	N.America	S.America	Asia	Australia	Africa	Annual totals
1991	120	130	83.4	3.5	4	4.4	345.3
1992	99.5	127.6	80.9	6.3	4.2	4.8	323.3
1993	81	132.5	79.9	9.3	4.9	2	309.6
1994	87.5	148	99.2	11.1	5.9	4.7	356.4
1995	108	169.3	104.8	15.1	6.2	5.7	409.1
1996	117.7	177	105.8	15.9	6.9	5.2	405.8
1997	108.3	189.2	80.2	15.9	6.9	5.2	405.8
1998	133.6	195	74.7	16.4	7.9	4.9	432.5
1999	133.6	239.1	80.4	8.3	7.9	4.3	473.5
2000	131	272.4	78.3	8.1	5.3	3.9	499
2001	140	254.1	67.7	5.6	5.5	3.8	476.7
2002	162.1	216	70.7	3.3	5.8	3.7	461.6
2003	192.5	223.9	77.7	4	7.6	5.6	511.33
2004	229.8	240.7	84.9	7.5	8.1	8.1	579.1
2005	231.6	236.7	82	13.9	8.2	9.6	582
2006	260.5	241.1	93.1	19.2	8.6	11.1	633.7
2007	367.1	237.9	118.7	41.4	4.1	11.2	780.4
2008	311.9	226.1	124	54.2	6.9	9.6	732.8
2009	211.5	190.8	112.7	30.2	5.7	6.5	557.3
2010	212.5	213.3	148.4	25.4	10.8	6.4	616.8

Source: London Financial group Global Leasing Report [6]

Review of Literature: Research studies on equipment Leasing are found to be very limited in India compared to developed countries like U.S.A, U.K, West Germany etc. there are number of studies conducted on leasing most of these are from United States.

Franzen, Rodgers, & Simin [7] in their study named "Capital Structure and the Changing role of Off Balance Sheet Lease Financing" uses the trend regression analysis to demonstrate the remarkable increase in Off-balance sheet (OBS) lease financing and decrease in capital lease over the period of last 27 years from 1980 through 2007. There findings include that firms rely heavily on the OBs financing in addition to conventional debt. The OBS leases increases 744.8% from 1980 to 2007, while capital leases decreases 49.8%. The benefit of the OBS accounting treatment of lease financing is a significant determinant of Corporate Capital Structure, as excess of OBS leasing increases, conventional debt ratios fall.

Aswath Damodaran[8] in his paper entitled "Dealing with Operating Leases in Valuation" state that most firm valuation models start with the after tax operating income, as a measure of the operating income. In using this measure of earnings we assume that operating expenses include only those expenses designed to create revenue in the current period and that they do not include any financing expenses and show them after operating income. He emphasized whether these expenses are really financing expenses and that ignoring this misclassification can create significant problems in measuring and comparing profitability.

Another significant study on "Leasing – a growing industry" by Brahmaiah [9] studied on the accounting practices of 60 leasing companies. The study focused on accounting practices of lessee companies. The study revealed that there is no uniformity in the accounting practices of lessee companies. Lessees show there leased assets in their balance sheets neither as assets nor as liabilities in view of their future rental obligations, making the lease transaction as the Off balance sheet transaction. Similarly, lessor do not show the lease rental to be received as receivables in their balance sheet. Lessees neither show their leased assets as assets nor as liabilities in view of their future rental obligations. Thus leasing is considered as off- balance sheet transaction in India. Mohinder Kaura [10] has published article on "Lease Financing of Equipment in India: development and prospects". This paper traces the development of lease financing of equipment in India. It makes useful suggestions for streamlining the industry as well as the policy governing the industry in the country. The article focused on global scenario and the leasing in Indian context, its recent developments and problems, the structure of leasing industry and determinants of success of leasing in India.

"Note on the Discussion Paper on Lease Accounting" by Nidhi Bothra [11] states that the Accounting Standards for leases has been under constant review for sometime now. There have been discussions on adopting a new approach in accounting, which will not distinguish leases based on Financial and Operating Lease but disclosures to be made on the basis of 'right to use' asset and 'obligation to pay rentals' liabilities. Bothra says the need of the discussion papers arises because as per the present Accounting Standard IAS - 17, in a financial lease the asset and Liabilities are recognized on the books of the lessee and the lease is more of a funding or financing transaction. On the other hand in case of operating lease the asset is not recognized in the books of the lessee.

"Depreciation dichotomy between Accounting Standard and Tax Laws on Financial Lease Transaction" by Nidhi Jain [12] states that over a few years, the instrument of lease fell out of popularity largely because of the tax issues. Among other tax issues, the major issue is depreciation allowance. When Accounting Standard (AS) 19 on "Leases" was introduced, it was expected that the requirement of capitalization of the leased asset by the lessee in case of financial lease transaction would be accepted by the income tax laws as well. But the circular issued by Central Board of Direct Taxes (CBDT) dated 9 February, 2001 wiped off such expectation and the intention of legislature by not recognizing financial lease for tax purpose became clearer.

"Legal and Regulatory Framework for Leasing in Russia During year 2000" by Bloom [13] studies that The International Monetary Fund is foretelling that the gross domestic product of Russia will amplify by two percent during the year 2000. Reports in the fall of 1999 indicate that the Russian economy may have grown by two percent during 1999 as compared to 1998. The "correction" in the value of the Russian Ruble and the cessation of speculative investments in high-yield securities in the fall of 1998, coupled with higher oil prices and stable government policies have, notwithstanding several changes in the head of the Russian government during 1999, quite possibly, laid the foundation for economic growth in Russia during the year 2000 and beyond

Period of the Study: The study would cover a span of 10 years i.e. April 2005 to March 2014. This span of period would sufficient to find out the financial performance and evaluation of select leasing company.

Objectives of the Study
The Study Specifically Aims At:

- To evaluate the overall performance of leasing company
- To analyze the financial performance of leasing company
- To evaluate liquidity and solvency position of leasing company
- To analyze the problems and prospects of lease financing.
- And finally to come out with suggestions and recommendations for enhanced growth of Lease Financing in India.

Hypothesis of the Study: In order to fulfil and achieve the stated objectives of the research, the study has been made on the basis of certain hypothesis bifurcated according to the various dimensions of lease financing. The hypothesis of the study has been made according to the objectives of the study.

For testing Hypotheses, the following hypotheses have been formulated:

H1: There is no significant impact of revenue on shareholders fund.

H2: There is no significant impact of current ratio on return on capital employed

H3: There is no significant impact of net profit ratio on return on capital employed

H4: There is no significant impact of debt equity ratio on return on capital employed

Profile of Sundaram Finance Limited: The Company was integrated on 11th August1954 and converted into a Public Limited in 1961. The main object of the company carries on hire purchase business and equipment leasing [14].

Sundaram investment has developed over the past decades on the foundations of fanatical customer service, fair business practices, efficient, safe and trusted financial policies.

Sundaram Finance diversified into leasing in 1981, when leasing was still in its conceptual stages in the country. Pioneering the growth of leasing with its flexible, cost-effective and tailor-made leases, Sundaram Finance today counts among its clientele some of the most reputed blue chip companies. Sundaram Finance has a diversified portfolio ranging from computers to aircraft. Be it lenders, depositors, shareholders, customers or employees, Sundaram Finance has always enjoyed an excellent relationship with all its stakeholders [15]. In fact, the Company owes its impressive track record to these long standing relationships. Today, Sundaram Finance has come a long way from its position of being the leading Hire-purchase Finance Company to become the leader in its chosen field.

Financial Structure of Sundaram Finance Limited: An exploration of sources and uses of funds of SFL has enabled to evaluate their financial and capital structure and also employment of funds into fixed as well as current assets. To understand the position of the SFL the consolidated statements of each item are shown in alarmed tables and also in graphical representation in chart.

Financial Structure of Sundaram Finance Limited *Rs.in Crores*

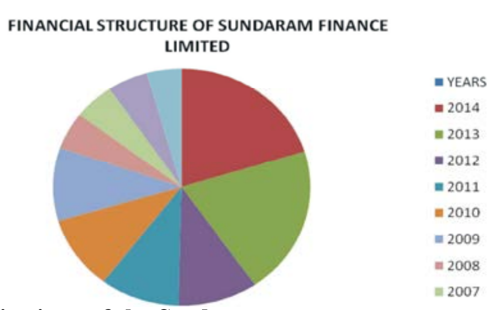
Years	SH. Capital	R&S	Borrowed Funds	F. Assets	C. Assets	Total Assets
2014	111	2293	13010	7909	7506	15415
2013	111	1976	12551	7552	7086	14638
2012	55	1733	11149	6795	6143	12938
2011	55	1750	12493	1946	13943	15889
2010	55	1261	8494	825	9659	10484
2009	55	1097	6262	766	7228	7994
2008	28	1015	6081	667	7085	7752
2007	28	850	5736	631	6384	7015
2006	28	829	5422	962	6092	7054
2005	24	655	3806	501	4280	4781

Source: Researcher compilation from annual reports of company

Equity share capital reveals about owner's equity. Share capital is gradually increasing from 24 crore to 111 crore and able to maintain the same level from 2009 to 2012 i.e. 55 crore.

R&S of any business is helpful in declaring dividends and also for expansion of business. It can be observed from the table that SFL reserves are 655 crore in 2005 and it has increased to 1750 crore in2011, then it has decreased to 1733 crore in 2012. Borrowed funds is continuously increasing from 3806 crore to 13010 crore except 2012 in which it has declined by 1344 crore.

The major development for a leasing company is on the acquisition of equipment to be given on lease. An asset acquired but given on lease is not shown in their balance sheet. F.A. of SFL varies from 501crore to 7909crore. As compared to F.A, C.A is found to be higher. Total application of funds is higher (15889crore) in 2011. The above stated data is also represented in the form of pie chart.



Limitations of the Study:

- The study is purely based on secondary data obtained from the annual reports of the company.
- Findings are limited for only ten years i.e from 2004-2005 to 2013-2014.

Testing of the Hypothesis:

H0: There is no significant impact of revenue on shaherholder's fund. Whereas, the alternative hypothesis says that there is significant impact of revenue on shaherholder's fund

Revenue vs Shaherholder's Fund: To test the hypothesis Simple Linear Regression Analysis has been used.

Descriptive Statistics

	Mean	Std. Deviation	N
SHFUND	1401.8000	584.60505	10
REVENUE	1413.5000	701.30691	10

Source: by using SPSS

Coefficients of revenue Vs shareholders fund

Model	Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	T	Sig.
(Constant)	287.098	149.204	.946	1.924	.091
REVENUE	.789	.096		8.257	.000

Source: by using SPSS

From the above table the unstandardized Beta Coefficients gives a measure of the contribution of each variable to the model. A large value indicates that a unit change in the predictor variable has alarger impact on the criterion variable. The result shows that the value of unstandardized Beta is .789 which is the indication of positive impact of revenue on shaherholder's fund. However this impact is statistically strong and significantly significant as the Sig.value (p) is .000 which is less than 0.05 (95% confidence interval). Therefore, the null hypothesis is rejected at the 0.05 significance level and it means that there is significant impact of revenue on shaherholder's fund under study.

H0: There is no significant impact of current ratio on return on capital employed. Whereas, the alternative hypothesis says that there is significant impact of current ratio on return on capital employed

Current Ratio vs Return on Capital Employed: To test the hypothesis Simple Linear Regression Analysis has been used.

Descriptive Statistics

	Mean	Std. Deviation	N
ROCE	3.2201	1.52356	10
CR	9.0437	5.94616	10

Source: by using SPSS

Coefficients of current ratio Vs return on capital employed

	Unstandardized Coefficients		Standardized Coefficients		
Model	B	Std. Error	Beta	T	Sig.
(Constant)	5.490	.193		28.406	.000
CR	-.251	.018	-.980	-13.844	.000

Source: by using SPSS

From the above table the unstandardized Beta Coefficients gives a measure of the contribution of each variable to the model. A large value indicates that a unit change in the predictor variable has alarger impact on the criterion variable. The result shows that the value of unstandardized Beta is -.251 which is the indication of negative impact of current ratio on return on capital employed. However this impact is statistically strong and significantly significant as the Sig.value (p) is .000 which is less than 0.05 (95% confidence interval). Therefore, the null hypothesis is rejected at the 0.05 significance level and it means that there is significant impact of current ratio on return on capital employed under study.

H0: There is no significant impact of Net profit ratio on return on capital employed. Whereas, the alternative hypothesis says that there is significant impact of net profit ratio on return on capital employed

Net Profit Ratio vs Return on Capital Employed: To test the hypothesis Simple Linear Regression Analysis has been used.

Descriptive Statistics

	Mean	Std. Deviation	N
ROCE	3.2201	1.52356	10
NPR	.1789	.02517	10

Source: by using SPSS

Coefficients of net profit ratio Vs return on capital employed

	Unstandardized Coefficients		Standardized Coefficients		
Model	B	Std. Error	Beta	T	Sig.
(Constant)	-3.606	2.998		-1.203	.263
NPR	38.166	16.615	.630	2.297	.051

Source: by using SPSS

From the above table the unstandardized Beta Coefficients gives a measure of the contribution of each variable to the model. A large value indicates that a unit change in the predictor variable has alarger impact on the criterion variable. The result shows that the value of unstandardized Beta is 38.166 which is the indication of positive impact of net profit ratio on return on capital employed. However this impact is statistically weak and insignificantly significant as the Sig.value (p) is .051 which is less than 0.05 (95% confidence interval). Therefore, the null hypothesis is rejected at the 0.05 significance level and it means that there is significant impact of net profit ratio on return on capital employed under study.

H0: There is no significant impact of Debt equity ratio on return on capital employed. Whereas, the alternative hypothesis says that there is significant impact of Debt equity ratio on return on capital employed

Debt Equity Ratio vs Return on Capital Employed: To test the hypothesis Simple Linear Regression Analysis has been used.

Descriptive Statistics

	Mean	Std. Deviation	N
ROCE	3.2201	1.52356	10
DER	5.1068	1.74946	10

Source:by using SPSS

Coefficients of debt equity ratio Vs return on capital employed

	Unstandardized Coefficients		Standardized Coefficients		
Model	B	Std. Error	Beta	T	Sig.
(Constant)	7.180	.753		9.539	.000
DER	-.775	.140	-.890	-5.532	.001

Source:by using SPSS

From the above table the unstandardized Beta Coefficients gives a measure of the contribution of each variable to the model. A large value indicates that a unit change in the predictor variable has a larger impact on the criterion variable. The result shows that the value of unstandardized Beta is -.775 which is the indication of negative impact of debt equity ratio on return on capital employed. However this impact is statistically strong and significantly significant as the Sig.value (p) is .001 which is less than 0.05 (95% confidence interval). Therefore, the null hypothesis is rejected at the 0.05 significance level and it means that there is significant impact of debt equity ratio on return on capital employed under study.

CONCLUSION

The Indian leasing and hire purchase sector contributes a large share in the GDP of the country. The future of the leasing industry is promising and its growth potential is high.

SFL is the most significant player in the leasing business; therefore proper policies for its financial restructuring are required. From the analysis and interpretation of data it has been concluded that the financial position of the company is quite satisfactory in terms of the liquidity and solvency position. The researcher concluded that the company has added a significant value in shareholders wealth. Current assets cover a major part of total assets which shows that the company has a big stock of leased assets while fixed assets are having a low percentage. In view of great divergence in the employment of funds by the leasing companies and for other purposes also it is required that the Companies Act, 1956 may be amended to create a separate cadre of "lease auditor".

Suggestions: Leasing by itself is a monetary mechanism, which develop the augmentation of Indian financial system but a certain quantity of vigilance is obligatory by leasing institutions mutually as well as quantitatively and qualitatively.

The govt. Of India and state governments have to slacken the lease related laws and practices. SFL should curtail its direct costs so as to recover productivity in requisites of sales and speed up trade activities to heighten up profitability in order to renovate the monetary strength. The company should use less debt as compared to equity in order to improve its solvency position and should trade a large share of its equity base in market to increase its market capitalisation and reduce its cost of capital so as to amplify shareholder's wealth.

In order to support and expand leasing industry in India, the government may loosen the depreciation allowance and investment allowance. RBI has to lighten up the active rules and regulations for import of capital goods. This will help many cross border companies in India to move towards to rise.

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