THE DETERMINANTS OF LEASING: EVIDENCE FROM CHINESE LISTED SMEs

LI TONGXIA

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Pusat Pengajian Pascasiswah
Universiti Malaysia Sabah
(Dr. Mohd. Rahimie Bin Abd. Karim)
Penyelia Utama

LI TONGXIA
MB1311072A

Tarikh: 29 April 2016
DECLARATION

I hereby declare that the material in this thesis is my own except for quotations, excerpts, equations, summaries and references, which have been duly acknowledged.

21st April 2016

Li Tongxia
MB1311072A
NAME : LI TONGXIA
MATRIK NO. : MB1311072A
TITLE : THE DETERMINANTS OF LEASING: EVIDENCE FROM CHINESE LISTED SMEs
DEGREE : MASTER OF BUSINESS (FINANCE AND BANKING)
VIVA DATE : 29th MARCH 2016

DECLARED BY

1. Supervisor
   Dr. Mohd. Rahimie Bin Abd. Karim
   Signature

   DR. MOHD. RAHIMIE ABD. KARIM
   Deputy Dean (Student's Welfare)
   Centre For Postgraduate Studies
   Universiti Malaysia Sabah

2. Co-Supervisor
   Assoc. Prof. Dr. Qaiser Munir

   DR. QAISER MUNIR
   Professor Madya
   Fakulti Perniagaan, Ekonomi & Perusahaan
   Universiti Malaysia Sabah
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Li Tongxia (李童侠)
21 April 2016
ABSTRACT

Although lease has been developed into one of the most important financing instruments, particularly for small- and medium-size enterprises (SMEs), few studies examine the determinants of leasing in China. This study investigates the determinants of leasing for a sample of China-based non-financial firms listed on the Shenzhen Stock Exchange SMEs Board over the period of 2009 to 2013. The methodologies employed in this study include ordinary least square (OLS), fixed effects (FE) model, random effects (RE) model, and instrument variable techniques. The empirical results show that operating lease share increases with ownership, tax rate, and firm size; it decreases with debt ratio, tangibility, and dividend dummy. Non-manufacturing firms are more likely to lease (both operating lease and capital lease). Capital lease share increases with debt ratio and firm size. Firms with a higher financial distress tend to use more capital lease financing. The test results for total lease share are similar to those for operating lease share. Finally, the robustness checks by employing 2SLS-FE and 2SLS-RE show consistent results.
ABSTRAK

PENENTU PAJAKAN : KETERANGAN PKS TERSENARAI DARI CINA

# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>TITLE</td>
<td>i</td>
</tr>
<tr>
<td>DECLARATION</td>
<td>ii</td>
</tr>
<tr>
<td>CERTIFICATION</td>
<td>iii</td>
</tr>
<tr>
<td>ACKNOWLEDGMENT</td>
<td>iv</td>
</tr>
<tr>
<td>ABSTRACT</td>
<td>v</td>
</tr>
<tr>
<td>ABSTRAK</td>
<td>vi</td>
</tr>
<tr>
<td>LIST OF CONTENTS</td>
<td>vii</td>
</tr>
<tr>
<td>LIST OF TABLES</td>
<td>xi</td>
</tr>
<tr>
<td>LIST OF FIGURES</td>
<td>xiii</td>
</tr>
<tr>
<td>LIST OF APPENDIXES</td>
<td>xiv</td>
</tr>
<tr>
<td>LIST OF ABBREVIATIONS</td>
<td>xv</td>
</tr>
</tbody>
</table>

## CHAPTER 1: INTRODUCTION

1.1 Background of the Study                  | 1    |
1.2 Problem Statement                        | 4    |
1.3 Research Questions                       | 6    |
1.4 Research Objectives                      | 8    |
1.5 Significance of the Study                | 9    |
1.6 Structure of the Study                   | 11   |

## CHAPTER 2: CONCEPTS AND DEVELOPMENT OF LEASING

2.1 Introduction                             | 13   |
2.2 The Concepts of Leasing                  | 13   |
2.3 Business Types of Financial Lease        | 19   |
2.3.1 Direct Financial Lease / Simple Financial Lease | 20   |
2.3.2 Sale and Leaseback (SLB)               | 20   |
2.3.3 Leveraged Lease                        | 21   |
2.3.4 Consignment Financial Lease           | 22   |
4.4 Variable Definition

4.4.1 Dependent Variables
a. Leasing Share
b. Ownership
c. Debt Ratio

4.4.2 Independent Variables
a. Tax Rate
b. Profitability
c. Financial Distress
d. Assets Specificity
e. Growth Opportunity
f. Firm Size
g. Tangibility
h. Corporate Governance

4.4.3 Instrument Variables

4.4 Extended Simultaneous Equations Model

4.5 Sample Selection

4.6 Summary

CHAPTER 5: EMPIRICAL RESULTS

5.1 Introduction

5.2 Descriptive Analysis

5.2 Empirical Analytical Procedures

5.2.1 Ordinary Least Squares

5.2.2 Random Effects Model and Fixed Effects Model

5.2.3 Two-Stage Least Squares and Generalized Method of Moments

5.3 Pairwise Correlation

5.4 Regression Analysis

5.4.1 Operating Lease Share
5.4.2 Capital Lease Share 116
5.4.3 Total Lease Share 118
5.4.4 First Stage Regression Results for Ownership and Debt Ratio 121
5.5 Robustness Test 123
5.6 Summary 125

CHAPTER 6: Discussion and Conclusion
6.1 Introduction 127
6.2 Factors that Influence Leasing Decision and the Relationship between Lease and Debt 127
6.2.1 Operating Lease 129
6.2.2 Capital Lease 132
6.2.3 Total Lease 134
6.3 Implications 135
6.4 Limitation and Directions of Future Research 137
6.5 Conclusion 138

REFERENCES 142
APPENDIXES 157
LISTS OF PUBLICATIONS 162
## LIST OF TABLES

<p>| Table 1.1: | Overview of Previous Studies on the Determinants of Leasing | Page |
| Table 2.1: | The Statement of Financial Accounting Standards No.13 (FAS No.13) | 17 |
| Table 2.2: | Accounting Standards for Business Enterprises NO.21-Lease (ASBE No.21) | 19 |
| Table 2.3: | Comparisons between Operating Lease and Capital Lease | 19 |
| Table 2.4: | Summary of Comparison between Leasing, Bank Loans, Bonds and Shares | 26 |
| Table 2.5: | Number of the Leasing Companies in China | 29 |
| Table 2.6: | Registered Capital and Lease Volumes of the China's Leasing Companies | 30 |
| Table 2.7: | Distribution of Financial Leasing Companies in China | 30 |
| Table 3.1: | Summary of Findings between Lease and Debt | 50 |
| Table 4.1: | Definition of Variables | 89 |
| Table 5.1: | Time Series of Capital Lease, Operating Lease, and Total Lease | 96 |
| Table 5.2: | Sample Firms by CSRC Two-Digit Industrial Category | 97 |
| Table 5.3: | Time Series of Dependent Variables | 99 |
| Table 5.4: | Summary Statistics | 100 |
| Table 5.5: | Skewness and Kurtosis for the Main Variables | 102 |
| Table 5.6: | VIF Test Results for Main Variables | 106 |
| Table 5.7: | Pairwise Correlations for the Main Variables | 112 |
| Table 5.8: | Operating Lease Share Regression | 115 |
| Table 5.9: | Capital Lease Share Regression | 117 |</p>
<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.10</td>
<td>Total Lease Share Regression</td>
<td>120</td>
</tr>
<tr>
<td>5.11</td>
<td>First Stage Regression Results</td>
<td>122</td>
</tr>
<tr>
<td>5.12</td>
<td>Robustness Test Results</td>
<td>124</td>
</tr>
<tr>
<td>6.1</td>
<td>Summary of Hypotheses and Findings</td>
<td>128</td>
</tr>
</tbody>
</table>
# LIST OF FIGURES

| Figure 2.1: | The Process of Leasing Transaction | 15 |
| Figure 2.2: | The Trend of Leasing Penetration Rate in the US, UK, Japan, and Korea from 1992 to 2011 | 27 |
| Figure 2.3: | Leasing Volumes among the Six Continents during 2002 to 2011 | 28 |
| Figure 2.4: | Sources of External Financing of SMEs in Euro Area during 2010 to 2011 | 32 |
| Figure 2.5: | SMEs’ Asset Investment Financed by Different Sources in 2010 and 2011 | 33 |
| Figure 2.6: | SMEs’ Asset Investment Financed by Different Sources in 2013 and 2014 | 34 |
| Figure 2.7: | SME Leasing Volumes by Country in 2010 | 35 |
| Figure 2.8: | SME Leasing Volumes by Country in 2013 | 35 |
| Figure 2.9: | Reasons to Use Leasing, 2013 | 36 |
| Figure 2.10: | Deal Structure | 37 |
| Figure 3.1: | Development of the Research on Leasing and Capital Structure Theory | 43 |
| Figure 3.2: | Vancil’s Seven Step Analysis Method for Selecting Leasing or Borrowing | 46 |
| Figure 4.1: | Relationships among Variables | 63 |
| Figure B.1: | Histograms for Dependent Variables | 159 |
| Figure B.2: | Frequency Histogram for Independent Variables | 160 |
| Figure B.3: | Frequency Histogram for Instrument Variables | 161 |
# LIST OF APPENDIXES

<table>
<thead>
<tr>
<th>Appendix A:</th>
<th>Skewness and Kurtosis Calculations</th>
<th>157</th>
</tr>
</thead>
<tbody>
<tr>
<td>Appendix B:</td>
<td>Frequency Histograms for Dependent Variables, Control Variables and Instrument</td>
<td>158</td>
</tr>
</tbody>
</table>
## LIST OF ABBREVIATIONS

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>2SLS</td>
<td>Two Stage Least Squares</td>
</tr>
<tr>
<td>ASBE</td>
<td>Accounting Standards for Business Enterprises</td>
</tr>
<tr>
<td>BOD</td>
<td>Board of Directors</td>
</tr>
<tr>
<td>CAPM</td>
<td>Capital Asset Pricing Model</td>
</tr>
<tr>
<td>CBRC</td>
<td>China Banking Regulatory Commission</td>
</tr>
<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>CLS</td>
<td>Capital Lease Share</td>
</tr>
<tr>
<td>CNINF</td>
<td>Chinese Listed Company Information Disclosure Website</td>
</tr>
<tr>
<td>CNY</td>
<td>Chinese Renminbi (Yuan)</td>
</tr>
<tr>
<td>CSRC</td>
<td>China Securities Regulatory Commission</td>
</tr>
<tr>
<td>CSRCIC</td>
<td>China Securities Regulatory Commission Industry Code</td>
</tr>
<tr>
<td>EPC</td>
<td>Energy Performance Contracting</td>
</tr>
<tr>
<td>ESC</td>
<td>Energy-Saving Company</td>
</tr>
<tr>
<td>FAS</td>
<td>Statement of Financial Accounting Standards</td>
</tr>
<tr>
<td>FE</td>
<td>Fixed Effects Model</td>
</tr>
<tr>
<td>GAAP</td>
<td>Generally Accepted Accounting Principles</td>
</tr>
<tr>
<td>GMM</td>
<td>Generalized Method of Moments</td>
</tr>
<tr>
<td>IPO</td>
<td>Initial Public Offer</td>
</tr>
<tr>
<td>IRC</td>
<td>Internal Revenue Code</td>
</tr>
<tr>
<td>IRR</td>
<td>Internal Rate of Return</td>
</tr>
<tr>
<td>MDB</td>
<td>Myers, Dill and Bautista Model</td>
</tr>
<tr>
<td>MM</td>
<td>Modigliani and Miller</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Full Form</td>
</tr>
<tr>
<td>--------------</td>
<td>-----------</td>
</tr>
<tr>
<td>NPV</td>
<td>Net Present Value</td>
</tr>
<tr>
<td>NTV</td>
<td>Net Terminal Value</td>
</tr>
<tr>
<td>OLS</td>
<td>Ordinary Least Square</td>
</tr>
<tr>
<td>OPLS</td>
<td>Operating Lease Share</td>
</tr>
<tr>
<td>PPE</td>
<td>Property, Plant and Equipment Value</td>
</tr>
<tr>
<td>RM</td>
<td>Malaysian Ringgit</td>
</tr>
<tr>
<td>RMB</td>
<td>Chinese Renminbi</td>
</tr>
<tr>
<td>SEC</td>
<td>Securities and Exchange Commission</td>
</tr>
<tr>
<td>SHSE</td>
<td>Shanghai Stock Exchange</td>
</tr>
<tr>
<td>SIC</td>
<td>Standard Industrial Classification</td>
</tr>
<tr>
<td>SLB</td>
<td>Sale and Leaseback</td>
</tr>
<tr>
<td>SMEs</td>
<td>Small- and Medium-Sized Enterprises</td>
</tr>
<tr>
<td>SOEs</td>
<td>State-Owned Enterprises</td>
</tr>
<tr>
<td>ST</td>
<td>Special Treatment</td>
</tr>
<tr>
<td>SZSE</td>
<td>Shenzhen Stock Exchange</td>
</tr>
<tr>
<td>TLS</td>
<td>Total Lease Share</td>
</tr>
<tr>
<td>UCC</td>
<td>Uniform Commercial Code</td>
</tr>
<tr>
<td>USD</td>
<td>U.S. Dollar</td>
</tr>
<tr>
<td>VAT</td>
<td>Value-Added Tax</td>
</tr>
<tr>
<td>VCE</td>
<td>Variance-Covariance Matrix</td>
</tr>
<tr>
<td>VIF</td>
<td>Variance Inflation Factor</td>
</tr>
<tr>
<td>WTO</td>
<td>World Trade Organization</td>
</tr>
</tbody>
</table>
CHAPTER 1

INTRODUCTION

1.1 Background of the Study

China has become the largest emerging market and the second largest economy in the world. The great success of its economic development is driven primarily by small and medium-sized enterprises (SMEs) which account for 98 percent of all firms and contribute 60 percent of the country’s GDP⁴. Meanwhile, 75 percent of the new products and 85 percent of the new employment are also from the SMEs. Nonetheless, a lack of appropriate external financing channels has become the major constraint in the development of Chinese SMEs (Shen, Shen, Xu, and Bai, 2009). For example, about 98.75 percent of SMEs (0.5 million over 40 million) have no access to bank loans (Lin, 2007). In response to this problem, the Chinese government has implemented a series of policies to improve the financial environment, which includes promotion of the leasing market. Moreover, the government has recognized the development of the leasing market as an important action in deepening financial reform. Therefore, understanding the determinants of SMEs’ leasing decisions in China is vitally important not only for academia but also for policy-makers.

"Leasing" is treated as an economic activity, in which the arrangement involves the owner (lessor) transfers the use of an asset to another party (lessee) which will compensate the lessor with fixed return (such as a monthly payment) for

the duration of the lease terms. According to Chai (2011), based on the Chinese historical records, leasing has been employed in the agriculture-based activities since the Chinese Zhou Dynasty (about 11th to 2nd century B.C.). Therefore, it can be argued that leasing as the trade mode has existed for thousands of years. To date, it has also become the one of the most important external financing instruments, particularly in the developed countries. For example, leasing has become the largest segment of asset-based financing in Canada (Callimaci, Fortin, and Landry, 2011).

Traditionally, there are two types of leasing, namely financial/capital leasing and operating leasing. Capital leasing, also called the "Modern Leasing", emerged in the 1950s in the US as an innovative financing tool, companies use the capital leasing to finance the acquisition of capital assets including equipment, buildings, machinery, and vehicles. It has been widely accepted in both developed countries and emerging markets, and plays significant role in financing investment. For example, it has become the second largest financing instrument in terms of financing volumes after bank loans, followed by the other forms of financing such as securities, insurance and trust. One-third of the fixed assets investments in the global banking industry comprise of capital leasing (Chen, Jiang, and Lin, 2014).

In 1981, the first Chinese capital leasing company, China Eastern Leasing Co. Ltd., was established by three shareholders, namely China International Trust and Investment Corporation, Beijing Electrical and Mechanical Equipment Co. Ltd., and Japan Eastern Leasing (Beijing) Co. Ltd. Unfortunately, the company was declared insolvent in 2008 (Han, 2010). Coincidently, the financial leasing industry in China started its new cycle after the 2008 global financial crisis which allowed the industry to register tremendous growth following the crisis.
Financial economists (e.g., Teng, 2012) argue that the capital leasing industry in China has completed its first business cycle that took about 30 years, which consists of the booming period (1981-1987), the problem exploring period (1988-1998) which was mainly for risks management purposes, and the recovery with an adjustment period (1999-2007). Currently, the industry is in the early phase of the second cycle which started after the recent financial crisis and is enjoying a substantial growth rate (Teng, 2012).

In 2007, a new guideline namely "Financial Leasing Company Management Regulation" was implemented in China. Under this regulation, the relevant authorities allow local financial institutions to set up or become the shareholders of "financial leasing companies" that are distinct from traditional financial leasing companies in the sense that the latter is only owned by foreigners and other non-financial institutions. According to the supervision agencies and investment subjects, financial leasing companies are classified into three types in China. The first type (labeled as "Type I") is capital leasing companies that are monitored by China Banking Regulatory Commission (CBRC). The second and third types (labeled as "Type II" and "Type III") are supervised by China Commerce Department. Type II is owned by Chinese local companies and is called "domestic capital financial leasing company". The Type III is called "foreign capital financial leasing company" which is owned by foreign companies or China-based companies registered overseas.

Until the end of 2012, there are 560 registered financial leasing companies in China (Shi and Xu, 2013). The total number of companies for each of the three different types are 20 (Type I); 80 (Type II); and, 460 (Type III), respectively. The total registered capital is RMB 189 billion (about US$ 30 billion or approximately RM91 billion). The value of the contracts is RMB 1,550 billion (about US$ 255 billion).

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or RM775 billion). The average annual growth rate is 1,060 percent (Shi and Xu, 2013). Despite the substantial growth, however, there is still a large gap between China and other developed counties. This is because when the degree of financial leasing development is measured, developed countries have 22 percent of penetration rate, far above the 4.14 percent in China (World Leasing Yearbook, 2013).

Therefore, to boost the development of Chinese lease market, it is essential to conduct a study to enrich our understanding. To this end, this study was designed to investigate the determinants of leasing decisions of Chinese SMEs.

1.2 Problem Statement

Over the past several decades, different theories have been developed explaining the determinants of firms' leasing decisions. However, both theoretical and empirical studies have focused on developed countries and large-sized companies. Little work has been done to understand leasing decisions in developing economies and SMEs, particularly China. Although the findings derived from developed countries are relevant to emerging markets, the distinct legal and institutional features as well as financial environments may potentially lead to significant differences (Demirgüç-Kunt and Maksimovic, 1998; Beck, Demirgüç-Kunt, and Maksimovic, 2008). Indeed, there is a gap in literature on whether the classic theories and findings derived from developed countries also work in developing countries. This paper attempts to fill in the gap and enrich our understanding by investigating the determinants of leasing decisions of non-financial firms from the perspective of developing countries, in particular, China.
In addition, building on these theories, a substantial amount of empirical studies provide evidence that firm and industry characteristics play important roles in determining corporate lease propensity. Yet, firms that are similar in terms of these fundamentals often have different leasing propensity. In other words, the corporate leasing decisions may depend not only on the characteristics of the firm and industry, but also on other characteristics, such as the demographic characteristics or personnel traits of the entrepreneurs (Neuberger and Räthke-Döppner, 2013). Thus, this has led scholars to recently investigate the impact of entrepreneurial characteristics on firm leasing propensity (e.g., Neuberger and Räthke-Döppner, 2013). However, the studies on this area are still rare, especially for developing countries. As the result, the existing literature may not be able to fully reveal the impact of personal characteristics. In particular, the previous studies are absence in answering whether these characteristics are also work in developing countries. The lack of knowledge about the impact of personal traits in determinants of leasing decisions has made a call for further research. The present study extends this work, but focusing on ownership of CEOs.

Moreover, motivated from the agency theory, this study also takes account for the influence of corporate governance factors. Likewise, there are rare previous studies to investigate the effect of corporate governance for firm leasing propensity. However, these factors are important and may influence firm financing decisions, because firms with strong corporate governance can effectively and efficiently to align the interest between shareholders and managers (Robicheaux, Fu, and Ligon, 2008).

Finally, although vast of prior studies have investigated the relationship between leases and debt, they find mix results, that is complementary or substitute relationship (Cosci, Guida, and Meliciani, 2015). Lin, Wang, Chou, and Chueh (2013)
present that mix results in the previous empirical research between lease and debts maybe introduced by failing to consider the simultaneous relations. Lewis and Schallheim (1992) also argue that researchers lost sight of the issue that leasing is simultaneously determined with capital structure can induce unauthentic results. In order to resolve this problem, the present study will appropriately set up the simultaneous research models and use instrumental variable method to estimate the models.

In summary, vast of previous research has investigated the determinants of leasing decisions, but they are focusing on large-size firms and developed countries. Unfortunately, however, prior empirical studies on leasing in the context of Chinese market, especially for SMEs, are rather limited. In addition, those of previous studies mostly concentrated on firm and industry-level characteristics, they are rarely to investigate the impacts of personnel traits of the entrepreneurs as well as corporate governance factors. To understanding more about the determinants of leasing propensity for Chinese market, this study will mainly focus to investigate the leasing decisions from lessee side and take into account for entrepreneur’s characteristics and corporate governance factors. In other words, this study aims to find out the factors that motivate lessees to lease assets in China. Furthermore, to investigate the relationship between leases and debt, this study will set up more appropriate models and use more advanced estimation technique that is instrumental variable method.

1.3 Research Questions

This study examines the leasing business in China particularly with regards to the factors determining the use of leasing as a financing tool amongst Chinese

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3The recent similar study has been done by Li (2014), who investigate the determinants of financial leasing for a sample of China-based firms listed on the SHEZ and SZEZ.
companies. Building on different theories, prior studies have revealed that firm and industry level characteristics play important roles in shaping lessee’s leasing decisions. Therefore, this study firstly attempts to answer the following research question:

a. What are the firm-and industry-level characteristics (factors) obtained from previous research in developed countries affect the Chinese SMEs’ leasing decisions?

b. How do these firm-and industry-level characteristics (factors) obtained from previous research in developed countries affect the Chinese SMEs’ leasing decisions?

In addition, rare previous studies also show that the personnel traits of entrepreneurs as well as corporate governance can influence lease financing decisions. In order to understand more about the impacts of these factors in shaping leasing decisions, this study also attempts to answer the following questions:

c. Does the CEO ownership influence the firm’s leasing decision in context of Chinese SMEs?

d. Does the corporate governance factors influence the Chinese SME’s leasing decision?

e. What is the relationship between CEO ownership and lease share for Chinese SMEs?

f. What is the relationship between corporate governance and lease share for Chinese SMEs?
REFERENCES


