

**THE DETERMINANTS OF LEASING:
EVIDENCE FROM CHINESE
LISTED SMEs**

LI TONGXIA



PERPUSTAKAAN
UNIVERSITI MALAYSIA SABAH

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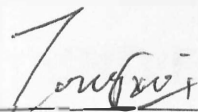
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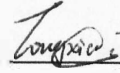
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ABSTRACT

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.



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ABSTRAK

PENENTU PAJAKAN : KETERANGAN PKS TERSENARAI DARI CINA

Walaupun pajakan telah berkembang menjadi salah satu instrumen pembiayaan yang paling penting, terutamanya untuk kecil dan sederhana (PKS), beberapa kajian pasti faktor penentu pajakan di China. Kajian ini mengkaji penentu pajakan untuk sampel firma berpangkalan di China yang tersenarai di Bursa Saham Shenzhen PKS Lembaga sepanjang tempoh 2009 hingga 2013. Metodologi yang digunakan dalam kajian ini ialah biasa supaya persegi, model kesan tetap, model kesan rawak, dan berubah-ubah instrumen teknik (IV). Hasil kajian menunjukkan bahawa bahagian pajakan operasi meningkat dengan pemilikan, kadar cukai, dan saiz firma; ia berkurangan dengan nisbah hutang, tangibility, dan dummy dividen. Syarikat bukan perkilangan adalah lebih cenderung untuk memajak (kedua-dua pajakan dan modal operasi pajakan). Saham pajakan modal meningkat dengan nisbah hutang dan saiz firma. Firma yang mempunyai masalah kewangan yang lebih tinggi cenderung untuk menggunakan lebih banyak pembiayaan pajakan modal. Keputusan ujian untuk jumlah keseluruhan pajakan adalah sama dengan bahagian pajakan operasi. Akhir sekali, cek keteguhan dengan menggunakan 2SLS-FE dan keputusan yang konsisten menunjukkan 2SLS-RE.



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LIST OF ABBREVIATIONS

2SLS	-	Two Stage Least Squares
ASBE	-	Accounting Standards for Business Enterprises
BOD	-	Board of Directors
CAPM	-	Capital Asset Pricing Model
CBRC	-	China Banking Regulatory Commission
CEO	-	Chief Executive Officer
CLS	-	Capital Lease Share
CNINF	-	Chinese Listed Company Information Disclosure Website
CNY	-	Chinese Renminbi (Yuan)
CSRC	-	China Securities Regulatory Commission
CSRCIC	-	China Securities Regulatory Commission Industry Code
EPC	-	Energy Performance Contracting
ESC	-	Energy-Saving Company
FAS	-	Statement of Financial Accounting Standards
FE	-	Fixed Effects Model
GAAP	-	Generally Accepted Accounting Principles
GMM	-	Generalized Method of Moments
IPO	-	Initial Public Offer
IRC	-	Internal Revenue Code
IRR	-	Internal Rate of Return
MDB	-	Myers, Dill and Bautista Model
MM	-	Modigliani and Miller

NPV	-	Net Present Value
NTV	-	Net Terminal Value
OLS	-	Ordinary Least Square
OPLS	-	Operating Lease Share
PPE	-	Property, Plant and Equipment Value
RM	-	Malaysian Ringgit
RMB	-	Chinese Renminbi
SEC	-	Securities and Exchange Commission
SHSE	-	Shanghai Stock Exchange
SIC	-	Standard Industrial Classification
SLB	-	Sale and Leaseback
SMEs	-	Small- and Medium-Sized Enterprises
SOEs	-	State-Owned Enterprises
ST	-	Special Treatment
SZSE	-	Shenzhen Stock Exchange
TLS	-	Total Lease Share
UCC	-	Uniform Commercial Code
USD	-	U.S. Dollar
VAT	-	Value-Added Tax
VCE	-	Variance-Covariance Matrix
VIF	-	Variance Inflation Factor
WTO	-	World Trade Organization



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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 GDP¹. 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

¹Source: <http://finance.sina.com.cn/hy/20120426/100211929864.shtml>

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). Coincidentally, 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 China². 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

²See: http://www.gov.cn/flfg/2007-03/27/content_562517.htm

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 countries. 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 R athke-D oppner, 2013). Thus, this has led scholars to recently investigate the impact of entrepreneurial characteristics on firm leasing propensity (e.g., Neuberger and R athke-D oppner, 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 limited³. 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

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 studies firstly attempts to answer the following research question:

- a. What are the firm-and industry-level characterises (factors) obtained from previous research in developed countries affect the Chinese SMEs' leasing decisions?
- b. How do these firm-and industry-level characterises (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 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?