

**THE RELATIONSHIP BETWEEN LEASING  
CONTRACT, INTERNAL AND EXTERNAL  
FACTORS WITH DEFAULT RISK OF  
LEASING COMPANIES IN IRAN**

**BY**

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# **HUBUNGAN DI ANTARA KONTRAK PAJAKAN, FAKTOR DALAMAN DAN FAKTOR LUARAN DENGAN RISIKO KEGAGALAN PEMBAYARAN BALIK OLEH SYARIKAT PAJAKAN DI IRAN**

## **ABSTRAK**

Syarikat-syarikat pemajakan mempunyai pelbagai aktiviti perniagaan di kalangan mereka. Hubungan kompleks ini menyebabkan kegagalan pemajakan dan memberi kesan limpahan ke atas institusi-institusi kewangan dan perbankan serta industri yang lain. Kebanyakan kajian yang sedia ada adalah berkaitan industri perbankan, dan amat sedikit kajian tentang syarikat pemajakan. Justeru, disertasi ini dianggap mampu memenuhi jurang yang wujud. Penyelidikan ini merupakan salah satu daripada hanya beberapa kajian yang menyelidik risiko kegagalan bayar balik dalam industri pemajakan. Tujuan penyelidikan ini tentang hubungan antara kontrak pajakan firma, faktor-faktor dalaman firma, faktor dalaman firma risiko kegagalan bayar balik di kalangan syarikat-syarikat pemajakan di Iran. Justeru, adalah diharapkan agar kajian ini dapat memperkayakan lagi literatur mengenai industri pemajakan di Iran. Kajian ini menggunakan data dari 34 buah syarikat pemajakan di Iran, dari tahun 2005 – 2012, untuk mengenalpasti penentu-penentu kegagalan bayar balik. Kajian ini menggunakan 13 angkubah yang bersandar risiko kegagalan bayar balik. Angkubah bebas dibahagikan kepada tiga kategori: 1) kontrak firma, 2) faktor-faktor dalaman firma dan 3) faktor luaran. Kajian ini menggunakan data panel syarikat syarikat pemajakan di Iran. Teori risiko kegagalan bayar balik, teori aliran tunai, teori agensi, teori kebergantungan sumber, teori pinjaman berdaulat, teori mungkir pinjaman dan teori kerugian digunakan untuk mengukur faktor-faktor luaran dan

dalaman. Gabungan bukti-bukti mencadangkan bahawa syarat-syarat kontrak firma seperti prabayar pendahuluan, kontrak insurans kredit, cagaran sekuriti, kontrak masa dan tempoh, cagaran dan jaminan, jumlah kontrak, dan juga faktor-faktor luaran seperti kadar faedah, inflasi, pertukaran asing, Keluaran Dalam Negara Kasar, prasarana, dan kegagalan bayar balik adalah penentu dalam proses penggubalan dasar berkaitan sektor pemajakan di Iran. Hasil empirikal menunjukkan bahawa faktor dalaman seperti saiz pajakan dan pemilikan tidak merupakan penentu penting kegagalan bayar balik. Keputusan disertasi ini menyediakan beberapa implikasi bagi penggubal dasar dalam industri pemajakan. Para penggubal dasar akan memerolehi manfaat dengan menggunakan prosedur yang berbeza untuk kegiatan pajakan. Kajian ini juga menyediakan pengalaman industri dan perniagaan yang bermanfaat tentang hubungan antara risiko kegagalan bayar balik oleh pemajakan.

# **THE RELATIONSHIP BETWEEN LEASING CONTRACT, INTERNAL AND EXTERNAL FACTORS WITH DEFAULT RISK OF LEASING COMPANIES IN IRAN**

## **ABSTRACT**

Leasing companies undertake numerous business activities among themselves. Such complex relationships imply that in the aftermath of a leasing failure, there has been spillover effects on other financial institutions, banks and industries. Most of the existing studies are related to the banking systems and there is not many literature on the leasing industry. This dissertation attempts to fill this gap. This research is one of the few studies which examines default risk in the leasing industry. The aim of this research is to investigate the relationship between leasing contract, firm's internal factors, external factors and default risk of leasing companies in Iran. It is hoped that this research would further enrich the literature on the leasing industry in Iran. The present study uses the data from 34 leasing companies in Iran, for the period from 2005 to 2012, to identify the determinants of default. For the current research, an eight year period was taken into consideration, from early 2005 to late 2012. This thesis use 13 variables, that is, 1 dependent variable and 12 independent variables. The dependent variable is the default risk and independent variables are in the three categories namely, firm's contract, firm's internal factors, and external factors. This study uses panel data of leasing companies in Iran. The theory of default risk, the theory of cash flow, agency theory, resource dependency theory, theory of sovereign lending, default theory of lending and ruin theory, are used for measuring the external and internal factors. The combined evidences suggest that a firm's contract conditions, such as upfront prepayment, credit insurance contract, security deposits, time and period of contract, collateral and guarantees, contract amount, as well as

external factors, such as interest rate, inflation, foreign exchange, Growth gross domestic product, infrastructure, and default are determinants in the policy-making process, involving the leasing sector in Iran. Furthermore, the empirical results indicate that a firm's internal factors, such as the size of leasing and ownership are not significant determinants of default. The results of this dissertation provide several implications for policy-makers in the leasing industry. Policy-makers would benefit by employing different procedures for leasing activities. This study also provides a beneficial industrial and business experience concerning the relationship between default risk and leasing.



## **CHAPTER 1**

### **INTRODUCTION**

#### **1.1 Introduction**

This chapter deals with the research design of the study. It outlines the motivations for the study, the problem statement, research questions, objectives and significance of the study. Further, the chapter describes the variables used, the research period and the population profile. The last section of the chapter summarises the organizational structure of the rest of the chapters in the thesis.

#### **1.2 Motivations for the Study**

As mentioned earlier, the Iranian banking system is mostly government owned. The Central Bank of Iran enforces stiff monetary policies to control inflation and economic downturns in the country. Due to the stiff regulations, the banking system in Iran was unable to meet the needs of the private sector (Rahmani, 2012). Moreover, the Iranian economy underwent three major setbacks as follows, in the past thirty years:

First, the revolution of 1979, which transformed the economic system of Iran from an oil based economy to a mixed economy (oil and non-oil), underpinned by Islamic laws and thoughts. This created a great deal of uncertainty among foreign investors (Tabrizi, 2009). Second, eight years of an imposed war that changed the Iranian economy into a war economy. Third, sanctions imposed by the Security Council of the United Nations, the United States and the European Union made it

difficult for international investors to invest in Iran, apart from other inherent limitations (Rahmani, 2012).

Given the above-mentioned setbacks, the international banking and financial institutions showed less interest to invest in Iran. The present stock market system in Iran is new and young, and small sized investors are not familiar with its structure. Furthermore, formalities for attracting companies and investors into the Iranian stock market are too complex. Hence, thus far only four leasing companies are listed on the Iranian stock market ( Iranian Bourse).

The banking system on the other hand was unable to support the huge surge in demand for financing. Therefore, the economic and social conditions necessitated exploring of new and innovative financial resources. This led to the creation of leasing companies in Iran (Tabrizi, 2009).

Although the number of leasing companies increased significantly in recent years in Iran, the share of leasing industry to the growth of GDP in Iran is only 1.25%, while globally the share ranges from 2.5% to 5% (Bucyte, 2011).

Table 1.1 indicates the contributions of financial institutions and leasing to the growth of leasing to growth of GDP (2005 to 2012).

Table 1.1: Contributions of Financial Institutions and Leasing to growth of GDP (2005 to 2012)

<b>Years</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
growth of GDP	5	7	8	8	8	8	3	5
Share of financial institutions to growth of GDP	2.6	2.6	2.8	2.8	3	3.2	2.5	2.7
Share of leasing to growth of GDP	0.15	0.11	0.14	0.12	0.12	0.11	0.12	0.13

Source: Central Bank of Iran (2005to 2012)

The contribution of the leasing industry to gross national product of Iran was 0.15 in 2005, but it decreased to 0.11 in 2006. In 2007 it marginally increased to 0.14

percent, but subsequently decreased to 0.12 percent in 2008. The percentage of contribution remained unchanged for 2009, but in 2010 it sharply decreased by 11% to 0.08 percent. Interestingly, an increase of 8% was recorded in 2011 and 8.3% in 2012. The contribution of the leasing industry to GDP globally ranged from 2.5 to 5 percent, while for Iran it was 1.425 percent.

Based on Table 1.2, the turnover of the leasing industry was USD 1,200 million in 2008, a 20% decline compared to the previous year. It increased by 17% to USD 1,400 million in 2009 but declined by 21% to USD 1,100 million in 2010. However, a 4% increase to USD 1,140 million was registered in 2011. In 2012, it reached USD 1,265 million, which reflected a significant increase of 11%. Turnover of the leasing industry is an important aspect that would be looked into and analyzed in the following chapters.

Table 1.2 demonstrates that the market-share of the leasing industry fluctuated between 2005 and 2012. The amount of the leasing activities in 2006 was USD 1,700 million, a decline of 15% compared to the previous year. Similarly, in 2007, it was USD 1,500 million, which showed a 12% decrease when compared to 2006. Table 1.2 shows the amount and percentage change in leasing activities in Iran and the contributions to the growth of GDP (GGDP) from 2005 to 2012.

Table 1.2: Change in Activities and Contribution to growth of GDP of the Leasing Firms in Iran (2005 to 2012)

<b>Year</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Activities (million US\$ )	2000	1700	1500	1200	1400	1100	1140	1265
% Change in leasing		-15	-12	-20	17	-21	4	11
Contribution to GGDP	0.15	0.11	0.14	0.12	0.12	0.11	0.12	0.13
% Change in GGDP		-27	21	-17	0	-9	8	9

Source: Central Bank of Iran (2005 to 2013)

Table 1.3 shows that most default lease payments during the period 2005 to 2012 were for private cars and public (government- owned) cars. Defaults in equipment and housing leasing were lesser than the defaults for private cars and public cars.

Table 1.3 Default Lease Payments (million US Dollar)

Activities	2005	2006	2007	2008	2009	2010	2011	2012
Private Cars	197.22	187.34	210.6	169.1	203.84	170.24	201.48	205.51
Public Cars	131.48	119.51	136.5	126.83	148.96	122.06	154.98	147.23
Equipment	10.38	9.69	31.2	22.76	31.36	25.7	27.12	27.66
Housing	6.92	6.46	11.7	6.5	7.84	3.21	3.87	3.89
Total	346	323	390	325.2	392	321.2	387.46	384.29

Source: Central Bank of Iran and the Kanoon Leasing Association of Iran, 2013

One main reason for lower deferred payments and also lower default rate in housing and equipment was the tremendous increase in housing prices in Iran. This, inevitably, translated into lower payments and lesser costs than the increase in housing prices. Tenants usually paid their installments on time and house deeds were easily transferred to the tenants.

### 1.3 Statement of the Problem

Currently, the public and financial/non-financial institutions as well as firms are aware of default risks. They have been exposed to and experienced it in their daily undertakings. Default risk is simply known as the possibility of being exposed to danger of any kind (damage, injury, loss, or any other negative happening) at any event and at any time. Default risk is inversely related to lack of trust. The greater the lack of trust, the higher the default risk (Bhattacharya, 2010). Given the constantly changing conditions in the economic systems, a wide variety of default risks facing

financial and non-financial institutions are evident. In fact, all institutions (industrial, service, financial, and government) encounter default risks of some kind in their daily operations. Among these institutions, the financial institutions are the most affected by default risks. In the financial sector default risk occurs when a borrower is unable to fulfill his promised commitments according to the agreed schedule. When a borrower faces financial difficulties due to weaknesses in the economy, possibility of a default arises. Infact, the single most important risk factor facing financial institutions is the default risk (Chava and Purnanandam, 2010). In the case of the leasing industry, default by a few lessees could result in enormous losses for the leasing company. As mentioned, default risk means that a lessee would not be able to keep his promise of making periodic installment payments at the stipulated times. Periodic payments are made irregularly or not at all, and this could lead to cash flow problems and liquidity constraints in leasing companies.

Therefore, the most important threat that a leasing firm could face regarding default risk, is the lessee's inability or lack of interest to meet his obligations (Schava and Purnandam, 2010). It is unfortunate that the leasing industry has witnessed a sharp increase in incidences of deferred payments (Rahmani, 2011). Despite efforts to curb default risks, the main reason for bankruptcy of leasing and other financial institutions is delay in repayments. Default risk affectsthe financial statements (balance sheets, profit/loss statements, etc.) of these firms (Tabrizi, 2009).

The increasing incidences of deferred payments and lack of financial resources are the major obstacles for Iranian firms, thus, giving rise to negative cash flows (Rahmani, 2012). Leasing companies have limitations in financing working

capital. They have to manage their assets according to the working capital requirements.

The biggest market for leasing companies in Iran, during the period 2005 to 2012, was the car leasing market. Car is a tangible asset and annual depreciation is relatively high compared to the other assets. This has resulted in an increase in default and deferred payments. Table 1.4 shows the ratios of default lease payments. The aforementioned categories are grouped based on yearly activity. In addition, Table 1.4 shows the variations in each activity. In 2005, the variation was 52% for private cars and it increased to 53% in 2006, and subsequently 54% in 2007. The percentage decreased by 53% in 2008, but increased by 55% in 2009, 57% in 2010, and 58% in 2011. The percentage of default for public cars was 38% in 2005, which declined to 37% in 2006 and remained at that level in 2007. The percentage of default payments continued to be 38% in 2008, 2009 and 2010. However, it increased to 39% in 2011 and 40% in 2012.

Table 1.4: Default Lease Payments (percentage)

<b>Year</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Private cars	52	53	54	53	55	57	58	56
Public cars	38	37	37	38	38	38	39	40
Equipment	6	6	6	7	6	4	2	3
Housing	4	4	3	2	1	1	1	1
Total	100	100	100	100	100	100	100	100

Source: Central Bank of Iran and the Kanoon Leasing Association of Iran, 2013

Table 1.5 shows the percentage of defaults in payments and deferred payments to overall activities of leasing companies during the period 2005 to 2012. As is evident, there was substantial increase (23.5%) in the total value of leasing activities. This could be attributed to greater diligence and sensitivity of the management of leasing companies. The managers recognized the need for having a

mechanism to ensure timely repayments and also developed a model to assess associated default risks.

Table 1.5: Percentage of Default Lease Payments to Value of Leasing from 2005 to 2012

Year	2005	2006	2007	2008	2009	2010	2011	2012	Average
Percent	24	23	22	22	24	22	26	25	23.5

Source: Central Bank of Iran and the Kanoon Leasing Association of Iran, 2013

It is clear that limiting a country's financial parameters into a boundary could be a difficult task, but its benefits such as risk sharing capability, could lead to financial prosperity and wellbeing (Rahmani, 2013).

Furthermore, the importance of factors contributing to credit worthiness, such as the economic variables, should be taken into consideration. This is crucial when risk profiles and default potentials of the leasing industry are being investigated. Though leasing companies depend on budgetary requirements, there are very few research reports that explore the extent to which economic variables affect the risk of default (Rahmani, 2012).

Previous research by Altman (1989), Balachander and Shamugam (1998), Balachander and Shamugam (1998), Muhammad (2005), Franke and Krahnert (2007), Bonfim (2009) Hosseni and Tabrizi (2009) concluded that internal factors or parameters of institutions are not the main factors influencing default risk. Hence, the external parameters or factors should also be taken into account. The internal factors or parameters are under the control of the management team, while the external parameters are beyond that of the management team. The combination of the internal and external factors could provide a better understanding of default risk.

Empirical studies also showed that the default risks of different parts of the economy are affected by different variables (Woo and Siu, 2004; Ching et al., 2007; Switzer and Wang, 2013; Abbas et al., 2013). A number of researchers mentioned that there is a direct relationship between terms of rental contracts, the contract amount and default risks (Schallheim and McConnell, 1985; Schmit, 2004; Marcia, 2007; Bandyo et al., 2010; Hoseini and Tabrizi, 2010). Others have also indicated an association between equity returns and default risks (Vassalou & Xing, 2004; Da et al., 2010; Young, 2011). Some researchers also highlighted a relationship between GDP, loan amount, time, and default risk (Akhigbe et al., 2007; Marcia, 2007; Bandyo & Saha, 2010; Wesabi & Nor Hayati, 2013; CastroIn et al., 2013; Wesabi & Nor Hayati, 2013). Earlier studies also showed that there is an association between default risk of public companies and type of their activities (Elsas & Krahn, 2000; Marcia, 2007; Hoseini & Tabrizi, 2010; Chen & Deng, 2013). Further, some empirical studies examined the relationship between rental deposits and credit risk (Grenadier, 1995; Wang, 2008; Abbas et al. 2013). Similarly, others looked at the relationship between interest rate and credit risk (Glennon & Nigro, 2005; Marcia, 2007; Andrew et al., 2009; Zribi & Boujelbène, 2011; CastroIn et al., 2013). There were efforts to classify the micro and macroeconomic variables into short-term and long-term variables. Short-term variables are micro economic variables that affect the companies for one to two years. Meanwhile, long-term variables are macroeconomic variables that affect the companies for more than two years (Marcia, 2007, Abbas et al., 2013).

The first classification of the variables is more common and often used. Most studies that used this classification found similar results in terms of the role of different types of variables in credit risk of the banking system.



It could therefore be ascertained that there are definite voids in the empirical studies concerning the relationship between default risk and economic variables. Leasing firms in Iran face shrinking market share, reducing contributions to GDP, and increasing deferred payments. Hence, the absence and/or shortage of research work in the area of default risk, along with the above mentioned factors, have been the main motivations for conducting the present research study.

#### **1.4 Research Questions**

Limited studies have been conducted on the default risks of the leasing industry. The lack of focus on the variables that affect the default risk of the leasing industry in Iran ignited the interest of the researcher to undertake this research. In this study, the variables are divided into two classes according to their nature, influence and the mode of collection. Internal variables include the firm's contract and firm's internal factors as well as external factors. The following questions are addressed in the current research:

- 1- Is there a relationship between a firm's contract and default risk?
- 2- Is there a relationship between a firm's internal factors and default risk?
- 3- Is there a relationship between external factors and default risk?
- 4- Is there a relationship between firm's contract, firm's internal factors, and external factors with default risk for various types of leasing activities?

#### **1.5 Objectives of the Study**

The objectives of this research study are:

1. To examine the relationship between firms' contracts and default risk in the leasing industry in Iran.

2. To study the relationship between firms' internal factors and default risk in the leasing industry in Iran.
3. To explore the relationship between external factors and default risk in the leasing industry in Iran.
4. To examine the relationship between firm's contract, firm's internal factors, and external factors with default risk in various types of leasing activities.

### **1.6 Significance of the Study**

This study provides valuable information to be used as guidelines for policy makers and managers in leasing companies. It would assist investors, managers, and policy makers to develop appropriate strategies and protect the leasing industry. It also adds to the existing body of knowledge in the literature on default risk.

This thesis further contributes to and improves the literature relating to the relationship between leasing industry, firm's contract and firm's internal factors, external factors, and default risks in Iran. It also adds to the literature concerning the relationship between ownership and leasing firm's contract and firm's internal factors, external factors, and default risks in Iran. The study concentrates on the leasing industry for the period 2005 to 2012 (this period represents significant changes and renewed practices in the economic environment) and deals with leasing companies in Iran. It is hoped that this study would further enrich the literature on the leasing industry.

### **1.7 Contributions of the Study**

There are three main contributors of this study. They are:

First, the 1979 revolution changed the economic system of Iran from being an oil based economy to a mixed economy (oil and non-oil). The eight years of war transformed the Iranian economy into a war economy and the sanctions imposed by the Security Council made it difficult for international investors to invest in Iran. In addition to that banking facilities are not enough to support the investments. Hence, the economic and social conditions led to the pursuit of new financial resources that is leasing.

The Iranian banking system is mostly government owned and the Central Bank of Iran enforces stiff monetary policies to control inflation and economic downturns in the country. Due to the stiff regulations, the banking system in Iran was unable to meet the needs of the private sectors. This has created leasing as the alternative source of financing to meet the financing needs of the private sectors. In view of that this study is crucial for the authorities and the managers to understand how to create more leasing activities and improve the performance of leasing industry.

Second, the increase in the percentage of defaults payments and the deferred payments of overall activities of leasing companies during the period 2005 to 2012 has become a real concern. There was a significant growth (23.5%) in the total value of leasing activities. Default risk affected the financial statements. The substantial increase could be attributed to greater diligence and sensitivity of the management of leasing companies. The managers recognized the need for having a mechanism to ensure timely repayments and also developing a model to assess associated default risks.

The increasing incidences of deferred payments and lack of financial resources were the major obstacles for Iranian firms, thus, giving rise to negative cash flows creates limited working capital for leasing companies. Hence, it is crucial to know what contributed to the defaults payments of leasing companies.

Third, the absence and/or shortage of research work in the area of default risk.

There are very few research reports that explore the extent to which economic variables affect default risk. Several studies including Hosseini and Tabrizi (2010) have investigated the relationship between size and ownership and default of the Agriculture Bank in Iran. However this study is different from the study of Hosseini and Tabrizi (2010) as this study investing the relationship between leasing firm contracts, firm's internal factors, external factors and default risk of leasing companies. It is hope that this study will provide beneficial industrial and business experiences concerning the relationship between default risk and leasing and fill the abovementioned gap.

The relationship between default risk and leasing is relatively a new topic in Iran. The results of this study are expected to shed some light on this reality and help to contribute to the growth of leasing companies in future.

### **1.8 Research Variables**

In this research, the variables are divided into two classes, according to their nature, influence, and method of data-collection. Internal variables are variables that are mainly related to internal and external factors. Any changes and decisions regarding them are effected by the leasing companies. They include firm's contract and firm's internal factors. The firm's contract include upfront prepayments, credit insurance

contracts, security deposits, percentage of lease, time or period of contract, collaterals and guarantees, and the contract amount. The firm's internal factors include ownership and size of leasing. External variables are those that are related to external factors. Any changes and decisions regarding them are beyond the control of leasing companies. They include interest rates, foreign exchange rates, inflation, and gross domestic product.

### **1.9 Organization of the Remaining Chapters**

This dissertation is organized into six chapters.

Chapter 2 focuses on the background of leasing. The issues addressed in Chapter 2 are concerned with leasing activity, global leasing, Middle East countries' leasing activity, banking system in Iran and leasing industry in Iran.

Chapter 3 reviews the empirical literature on leasing structure and risk that are related to this study. The issues addressed in Chapter 3 include leasing structure and default risk framework, theoretical models, and measurements of default risk in leasing activity as well as previous empirical studies relating to default risk in leasing. The theoretical framework of this research as well as the structure-cash flow and default risk theories, the Merton, Vassalou and Xing as well as the Nenovsky and Dimitrova frameworks are also discussed. The main theory in this thesis is the cash flow theory. In addition, this chapter explains the evolution and development of leasing companies in Iran during the period 2005 to 2012.

Chapter 4 focuses on the research methodology. The study uses quantitative research methodology and includes discussion on hypothesis development, research framework, research design, operational definitions, and measurement of the

dependent and independent variables of the study and the statistical methods used for data analysis.

Chapter 5 presents the quantitative analysis of the leasing industry in Iran. The chapter also provides the findings and discussions pertaining to the time series and cross-sectional data and testing of the twelve hypotheses of the research study.

Chapter 6 concludes the study by restating the research objectives, summarizing the findings and discussing the limitations of the study and offering suggestions for future research work on the subject.

### **1.10 Summary**

This chapter highlighted the gaps in default risk studies on leasing companies. It showed that there is a lack of sufficient studies in this area, especially concerning the leasing industry in Iran. The chapter elaborated on the research problem and proposed research questions to be addressed in the current study.

Overall, this research developed a model to examine the influence of internal and external factors on default risks of leasing companies in Iran.

## **CHAPTER 2**

### **BACKGROUND OF LEASING INDUSTRY**

#### **2.1 Introduction**

The lessee and also the lessor to the lease are individuals or legal entities representing firms or organizations. Over the years, lease agreements have served many purposes and the nature of legal regulations for such agreements has gone through changes, depending on the purpose and socio-economic conditions prevailing at that time. For example, lease was mainly used in the agriculture sector until the late 18th and early 19th centuries. In early 19th century, the unprecedented growth in urbanization in the industrialized countries led to the use of lease agreement as an important document for land ownership in cities.

#### **2.2 Leasing Activities**

##### **2.2.1 Global Leasing Activities**

Table 2.1 and Figure 2.1 show that Europe witnessed a decline of 32.2% in its lease trade volume during the years 2008 to 2009. North America, Asia, Australia, New Zealand, Africa and South America also experienced a decrease of 15.6%, 9.1%, 6%, 41%, and 44.3% respectively, in their lease trade volume between 2009 and 2010 (Figure 2.2). However, the lease trade volume in Europe, North America, Asia and Africa increased by 0.5%, 11.8%, 31.7%, and 13.1% respectively, during the same period. Between the years 2009 and 2010, South America, Australia and New Zealand witnessed a decline of 15.9%, and 1% respectively, in their lease trade volume.

Table 2.1: Global Lease Volume (2008-2012)

<b>Area</b>	<b>Lease Volume (USD Million)</b>	<b>Growth from 2008 to 2009 (%)</b>	<b>Growth from 2009 to 2010 (%)</b>	<b>Percent of total activity in 2008</b>	<b>Percent of total activity in 2009</b>	<b>Percent of total activity in 2010</b>	<b>Percent of total activity in 2011</b>	<b>Percent of total activity in 2012</b>
Europe	212.5	-32.2	0.5	42.6	37.9	34.4	34.5	38.8
North America	213.3	-15.6	11.8	30.8	34.2	34.6	40.4	36.2
Asia	148.4	-9.1	31.7	16.9	20.2	24.1	18.5	20.7
Australia & New Zealand	10.8	-0.6	-1	0.9	1.2	1.8	3.8	1.9
Africa	6.4	-41	13.1	1.3	1	1	1.7	1.5
South America	25.4	-44.3	-15.9	7.4	5.4	4.1	1.2	0.9
<b>Total</b>	<b>616.8</b>			<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: World Leasing Yearbook (2011, 2014).

The reason for the surge in the global lease volume through 2008 and 2012 could be attributed to the influence of the financial crisis at the end of the first decade of the twenty-first century on global economic activities. The effects on countries with heavy reliance on petroleum were however lower. China endured this financial crisis well as it was able to readily reorganize its financial structure towards fostering production of new goods. Furthermore, as China had a substantial share in the leasing industry in Asia, the sector was less affected in the continent compared to other areas. In the past twenty years, there has been considerable growth in the global leasing industry. Though still a growing sector, the leasing industry has been able to attract one-third of the capital and durable goods market share. Measurement of the market share for leasing industry could be done in two ways: the first is the estimation of the amount of fixed investment of a given leasing firm, its means of securing necessary capital for investment, and investment in durable goods. This method was used in many countries in 1978 (Miri, 2008). The second method deals



with the evaluation of the share of the leasing industry in the Gross Domestic Product, in terms of its growth rate. This is done by an analysis of the financial sources of the leasing industry and the strength of the leasing industry in a country.

Based on Figure 2.1, to 2.4, it could be ascertained that lease financing played a pivotal role in funding capital goods in large economies. In the past two decades, the leasing industry was one of the most influential sources of financing that enjoyed a large share in the capital market and financing of durable goods.

As shown in Figure 2.1, the largest and widest range of leasing activities in 2009 were in Europe (37.9%), North America (34.2%), and Asia (24.1%). In contrast, the least number of leasing activities were in South America (4.1%), Australia & New Zealand (1.8%), and Africa (1%).

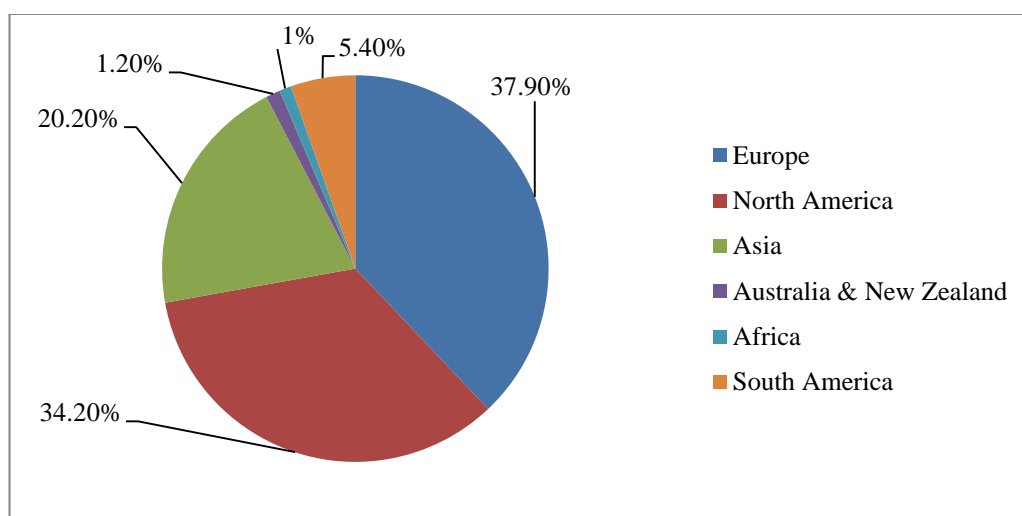


Figure 2.1: Global Leasing Activities by Area in Year 2009

Source: World Leasing Yearbook, 2012

Figure 2.2 shows the lease trade volume in Europe, North America, Asia, Australia and New Zealand, Africa and South America as 34.4%, 34.6%, 24.1%, 1.2%, 1% and 5.4% respectively in 2010. The data shows the same amount of

activities as in 2009, i.e. the largest number of activities was in Europe, North America, and Asia and the least number of activities was in South America, Australia & New Zealand, and Africa.

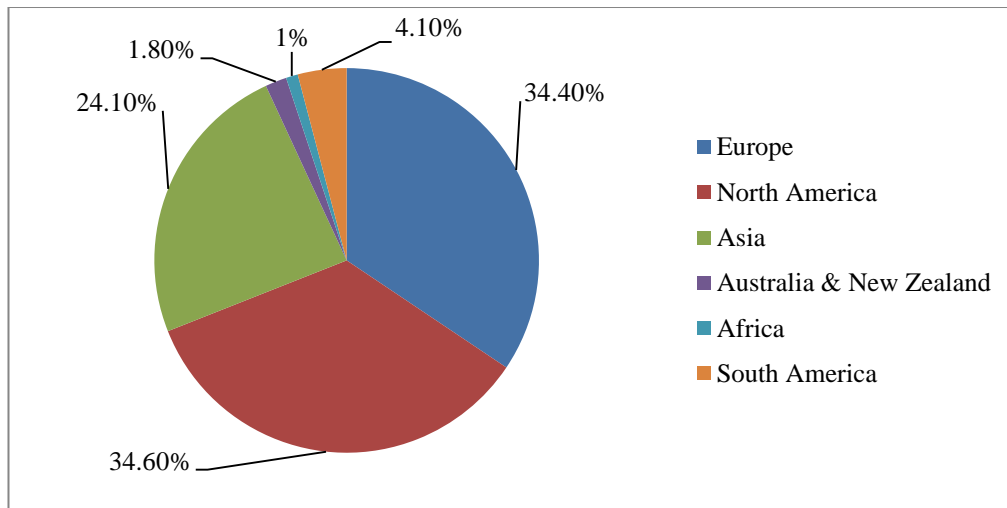


Figure 2.2: Global Leasing Activities by Area in Year 2010

Source: World Leasing Yearbook, 2013

Similarly, Figure 2.3 shows that the largest and widest range of leasing activities in 2011 were in North America (40.4%), Europe (34.5%), and Asia (18.5%), and the least number of activities was in South America (3.8%), Australia & New Zealand (1.7%), and Africa (1.2%).

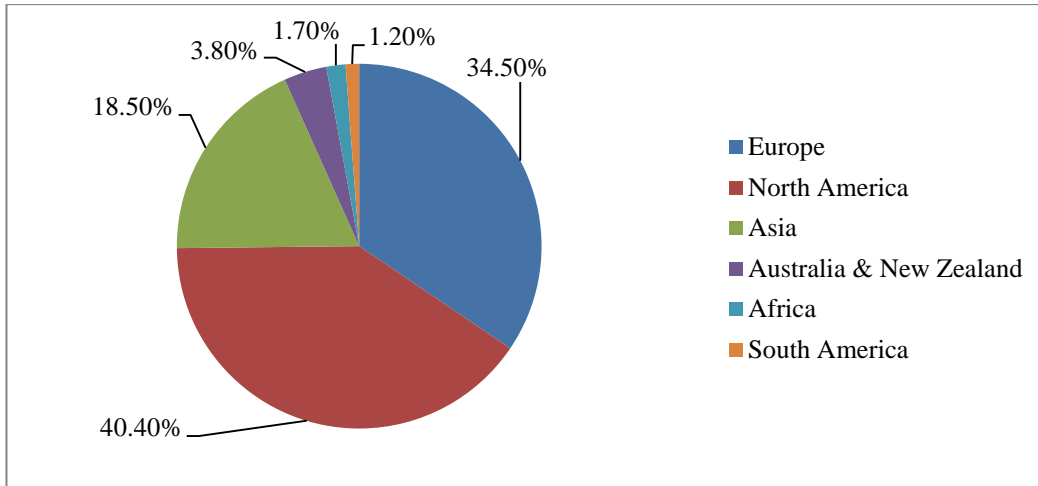


Figure 2.3: Global Leasing Activities by Area in Year 2010

Source: World Leasing Yearbook, 2013

Finally, Figure 2.4 demonstrates the trade volume in Europe, North America, Asia, Australia and New Zealand, Africa, and South America as 38.8%, 36.2%, 20.7%, 1.9%, 1.5% and .9% respectively, in 2012.

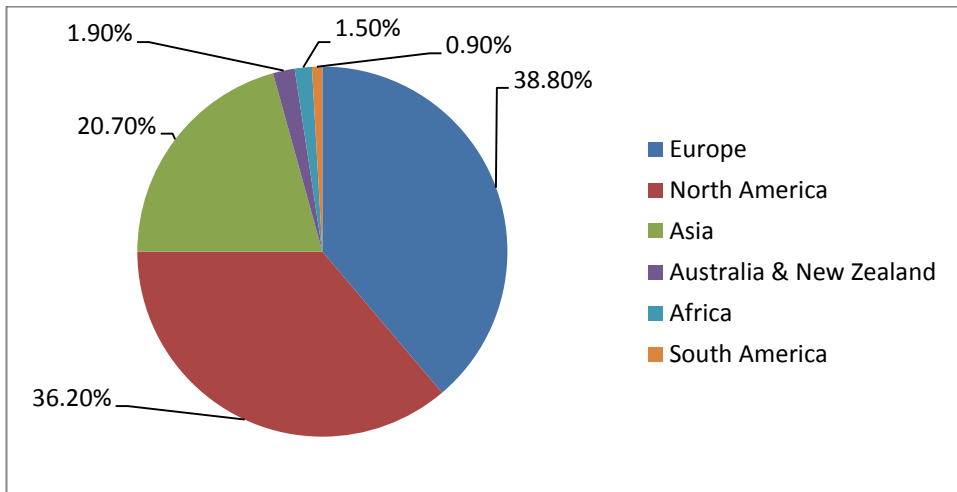


Figure 2.4: Global Leasing Activities by Area in Year 2012

Source: World Leasing Yearbook, 2014

Table 2.2 shows the lease trade volume in 18 countries, for the period from 2011 to 2013. The business volumes in the USA, which ranked first, were US\$ 317.88bn, US\$ 294.34bn and US\$ 268.80bn for 2011, 2012 and 2013 respectively.

China ranked second with US\$ 88.90bn, US\$ 88.66bn and US\$ 80.39bn respectively for the said period. In 2011, Iran registered a growth of 40.86%, while Egypt, a decline of 53.01%. In 2012, there was a 41.67% growth in China, while France experienced a decline of 28%. Iran showed a 40.86% growth in 2013, while Egypt a 53.01% decline. The dominant players, Germany and the UK accounted for 42.3% of the European market and 16% of the world market. Germany is the region's largest country for equipment leasing and, in 2013, it supplemented Japan as the third largest country in the world for new business leasing volume, following the US and China. New businesses amounted to US\$71.31bn, representing a modest decline of 0.33%. Leasing companies fared better than their finance company competitors, increasing their market share.

Table 2.2: Global Lease Volume and Market Penetration (2011-2013)

Country	2012–13				2011–12				2010–11			
	Annual volume (US\$bn)	% Growth	% Market penetration	Ranking	Annual volume (US\$bn)	% Growth	Annual volume (US\$bn)	Ranking	Annual volume (US\$bn)	% Growth	Annual volume (US\$bn)	Ranking
Us	317.88	8	22	1	294.34	9.50	22	1	268.80	38.86	21	1
China	88.90	-2.59	3.1	2	88.66	41.67	3.8	2	80.39	42.85	4.97	2
Germany	71.31	-0.33	16.6	3	66.34	112	5.8	4	80.11	0.33	16.6	3
Uk	69.79	12.61	31	4	61.66	9.56	23.8	5	69.79	12.61	31	4
Japan	62.26	12.61	31	5	69.95	6.23	7.2	3	62.26	12.61	31	5
France	34.31	-2.88	12.5	6	33.81	-0.28	12.8	7	34.31	-2.88	12.5	6
Russia	25.22	.039	5	7	25.50	7.10		8	25.22	.039	5	7
Sweden	20.82	-2.57	24.4	8	20.33	15.95	24.6	9	20.82	-2.57	24.4	8
Italy	18.93	.027	9.4	9	18.17	-22.22	10	10	18.93	.027	9.4	9
Canada	12.47	8	32	10	37	15.63	20.8	6	12.47	8	32	10
Korea	9.44	-2.87	8.1	14	10.22	-1.20	8.5	13	9.44	-2.87	8.1	14
Taiwan	8.54	12.61	9.2	15	7.80	14.80	8.2	15	8.54	12.61	9.2	15
Turkey	5.68	15.27	6.9	21	5.36	9.60	5.9	24	5.68	15.27	6.9	21
Spain	5.68	-6.10	4	22	5.57	-22.94	41	22	5.68	-6.10	4	22
Belgium	5.64	-9.90	8.7	23	5.99	0.12	8.9	19	5.64	-9.90	8.7	23
Malaysia	1.91	21.12	4	33	2.71	-11.70	-	29	1.91	21.12	4	33
Iran	0.92	40.86	5.4	41	0.87	-16.47	-	41	0.92	40.86	5.4	41
Egypt	0.44	-53.01		47	1.03	22.80	-	39	0.44	-53.01	-	47

Source: World Leasing Yearbook (2013, 2015).

## 2.2.2 Middle East Countries' Leasing Activities

The World Leasing Yearbook estimates the Middle East countries' leasing activity volume to be USD 6.36 million in 2009, USD 10.51 million in 2010 and USD 10.7 million in 2011. Table 2.3 shows that Turkey and Egypt experienced a decline of 59 % and 66% in their lease trade volume from 2008 to 2009, while Iran witnessed an increase of 5%. Turkey, Iran, Egypt, and other Middle East countries saw an increase of 0.50%, 121%, 121%, and 29%, respectively in their lease trade volumes between 2009 and 2010. During 2010 and 2011, Turkey witnessed an increase of 51%, but Iran and Egypt experienced a decrease of 45% and 42%, respectively in their lease trade volumes.

The reason of these differing amounts could also be attributed to the same reason provided for global inflation, i.e. the influence of the financial crisis at the end of the first decade of the twenty-first century on global economic activities. However, the increase in Iran's activity could be due to the economy's dependence on oil until 2009, while the decline in its activities in 2010 and 2011 could be due to the economic sanctions imposed by other countries.

Table 2.3: Middle East Countries Lease Volume (2008-2011)

Area	Lease Volume 2009 (USD Million)	Growth from 2008 to 2009 (%)	Lease Volume 2010 (USD Million)	Growth from 2009 to 2010 (%)	Lease Volume 2011(USD Million)	Growth from 2010 to 2011(%)	Percent of total activity in 2009	Percent of total activity in 2010	Percent of total activity in 2011
Turkey	1.9	-59	2.85	50	4.29	51	30	27	42
Iran	1.4	5	3.1	121	1.7	-45	22	29	17
Egypt	0.66	-66	1.46	121	0.88	-40	10	14	9
Others	2.4	-0.6	3.1	29	3.2	3	38	30	32
Total	6.36		10.51		10.07	100	100	100	100

Source: World Leasing Yearbook (2011, 2014).

### **2.3 Background of the Financial System in Iran**

Following the revolution in 1979, the government of Iran introduced measures to convert the conventional financial system into an Islamic financial system. In 1983, the law of Usury-free Financing was passed in parliament, and in 1984, interest-free financial institutions began their operations under the rules of Islamic financing.

The process of Islamization of the financing system in Iran underwent two phases. In the first phase, from 1979 to 1982, the financing system was nationalized and reorganized. In this phase, internal and external conditions did not allow policymakers in Iran to construct an expedient plan for Islamization of the financing system. The second phase commenced in 1982, which redefined liabilities, bank assets, and facilities.

#### **2.3.1 Banking System in Iran**

As mentioned earlier, before the revolution in 1979, Iran had a conventional banking system. After the revolution, government of Iran introduced the Islamic banking system to replace conventional banking. Most of the banks (28 out of 36) that observed usury-free financing were nationalized and some financial institutions were dissolved. As a result, the number of banks in Iran was reduced to nine (six commercial and three specialized banks) (Hassani, 2010).

It should also be mentioned that most of the Iranian banking system is owned by the Iranian government and the Central Bank enforced strict monetary policy to control inflation and economic downturns. For this reason the banking system was unable to meet the needs of the private sector in Iran (Rahmani, 2011).

After the end of Iran and Iraq war and during the reconstruction period in Iran, a new banking system was established and the Iranian economy gathered its development momentum. It was during this period that the need for increased financial resources became evident. However, the banking system was unable to support such high demands for financing. Therefore, there was a dire need to explore new financing modes and this led to the creation of leasing companies in Iran (Tabrizi, 2009).

### 2.3.2 Leasing Industry in Iran

Leasing industry in Iran flourished in the 1970s, but most of the leasing companies were established in the last 30 years. This is evident from Table 2.4.

Table 2. 4: Registered Leasing Companies in Iran

<b>Year</b>	<b>Number of registered companies</b>	<b>Asset (US Dollars million)</b>
2002	31	656.800
2003	61	912.800
2004	203	2,407.587
2005	276	2,856.415
2006	288	3,112.387
2007	296	4,116.368
2008	299	4,655.361
2009	301	4,981.356
2010	302	5887.855
2011	303	5,907.351
2012	300	5,823,621

Source: Central Bank and Kanoon Leasing Association of Iran, 2013

The earliest established leasing companies in Iran were Iran Leasing Company” and “Sanat and Ma’dan Leasing Company”. The former was registered and commenced business in 1970 and the latter in 1975. Iran experienced rather low growth in the number of leasing companies in the past two decades. The Iranian