

The Leasing Industry and Related Business Opportunities in China: Based on the Utilization of Measures for the Free Trade Zones

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The modern leasing industry in China is finally stabilizing after a series of twists and turns over the past 30 years. In particular, the industry has gone through a remarkable growth since it was identified as one of the most important industries for growth in the 12th Five-Year Plan (2011–2015), which has boosted the remaining balance of currently outstanding leasing contracts to a size of 30 times that of 10 years ago. This article gives an overview of the leasing industry in China, analyses preferential governmental policies to support the growth of the industry, and discusses potential business opportunities for Japanese companies based on research results and interviews with the authorities.

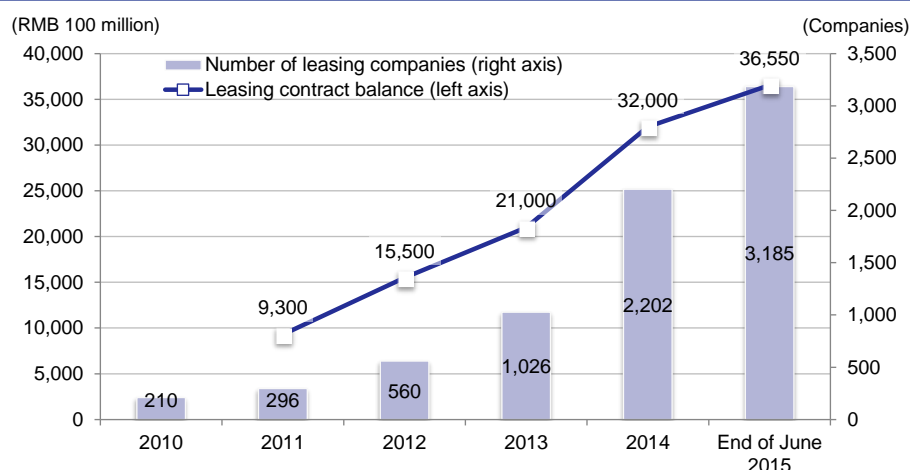
Overview of the leasing industry in China¹

The foundation of the modern leasing industry in China dates back to the 1980s. In response to the demand for funds and advanced foreign equipments generated from the rapid industrial development under the Reform and Opening-Up Policy, the central government introduced the concept of finance lease from Japan and the U.S. This gave birth to the first leasing company in China, China Orient Leasing Co., Ltd., a joint venture formed by a state-owned investment company under operational guidance from Japan. However, the industry quickly reached a deadlock due to frequent defaults on the back of national state-ownership reform and a hollow legal system. It is no exaggeration to say that there was almost no new investment in this industry during the 1990s.

¹ In this article, “leasing industry” merely refers to finance leases and does not include operating leases.

The situation mentioned above was finally improved in the mid-2000s. In 2005, the ban on the establishment of fully-owned leasing companies by foreign companies was lifted. At the same period, the requirements to establish domestic leasing companies were also relaxed. The above resulted in a gradual increase in the number of leasing companies. Stimulated by various promotional policies announced by the Free Trade Zones and other local governments since 2013, the leasing industry in China has recorded a remarkable growth and as of the end of June 2015, the outstanding balance of the leasing contracts in China amounted to approximately RMB 3.6 trillion (equivalent to approximately JPY 72 trillion, with the conversion rate of RMB 1 = JPY 20), which is roughly five times the balance seen five years ago (Fig. 1). By the first half of 2016, the country is expected to surpass the U.S. and become the world's top, in terms of the leasing volume.²

Fig. 1: Number of leasing companies and the outstanding balance of leasing contracts in China



Source: *China Financial Leasing Industry Development Report 2014* and statistics data issued by the China Leasing Alliance

The total number of leasing companies as of the end of June 2015 was 3,185. In terms of the type of investors, foreign-capital leasing companies account for more than 90% of the total number of companies and around 30% of the total outstanding balance of the leasing contracts. The vast majority of the companies are registered in pilot model districts such as Shanghai, Tianjin, and Guangdong Province, which may imply expectations for pilot policies in such Free Trade Zones (Fig. 2).

² 中国租赁联盟《2014 年融资租赁业发展报告》(China Leasing Alliance, *China Financial Leasing Industry Development Report 2014*)

**Fig. 2: Number of leasing companies by investors/region
(as of the end of June 2015)**

(Companies)	Financial leasing companies	Financing leasing companies		Total number
		Domestic	Foreign	
Shanghai	7	17	963	987
Tianjin	7	17	413	437
Guangdong Province	2	7	553	562
National	39	191	2,955	3,185

Note: Financial/financing leasing companies are mainly classified by the competent authorities. Financial leasing companies are categorized as financial companies supervised and managed by the China Banking Regulatory Commission, while financing leasing companies are categorized as general companies supervised by the Ministry of Commerce of China.

Source: Statistics data issued by the China Leasing Alliance (As of the end of June 2015)

However, according to interview results with various related sections, the operational ratio of leasing companies in China is merely less than 50%. It seems that the environment surrounding the leasing industry is still tough under the underdeveloped legal system, the lack of industrial statistics and companies' credit information, the shortage of human resources and funding, etc.

An improving business environment for the leasing industry

Still, as the leasing business attracts more and more attention, there have been various new measures to promote the development of the leasing industry with respect to overall supervision and management, laws and regulations, taxation systems, and governmental measures to enhance the development in the industry

First of all, in terms of supervision and management, the Ministry of Commerce of China issued the *Administrative Measures for the Supervision on Financing Leasing Companies*³ for the first time for the industry in September 2013, in order to enhance management of financing leasing companies. Since the enforcement of these Administrative Measures and other related regulations, all financing leasing companies are required to register their corporate information, business conditions, and lease properties, etc., in the *Management Information Systems of the Financing Leasing Companies Nationwide*⁴, and to go through annual inspection by the local competent authorities. The contents registered on this system have been made public to general users, contributing to the enhanced information transparency related to leasing companies.

From the perspective of leasing companies, the companies have finally realized access to official credit information, which used to be a huge obstacle for business operation. Currently, the only official credit search

³ 《融资租赁企业监督管理办法》(商流通发[2013]337号) (Letter of the Ministry of Commerce [2013] No. 337)

⁴ Ministry of Commerce of China 「全国融资租赁企业管理信息系统」

agency in China is under the control of the People's Bank of China, the data of which used to be accessible only to commercial banks. Recently, the data has been released to financing leasing companies in Tianjin and Guangdong Province under a pilot program. In the times ahead, China is expected to further develop its domestic credit environment which will bring a strengthened credit management system for leasing companies.

The legal and taxation system has been remarkably improved. In 2013, the Ministry of Commerce announced the resumption of legislative work for the *Financing Leasing Law*, which has been put on hold for nearly 10 years. Meanwhile, in order to standardize the overall leasing industry, more than 40 related laws and regulations as well as legal interpretations were released nationwide, and standards were set up for contracts, lease properties and information disclosure, etc., related to the leasing business.

Also, there has been a reform in the taxation system. Previously, business tax was levied on the leasing business, and therefore, companies that use leasing services were put to a disadvantage as they were not able to conduct tax deduction of the value-added tax on the lease assets. However, since the circulation tax reform in 2012, such disadvantage has been resolved with the business tax on lease assets replaced by the value-added tax. Furthermore, if a leasing company has a registered capital equivalent to RMB 170 million, it is now possible to calculate the value-added tax base by deducting financing costs from operating income. In addition, it is also possible to receive an immediate tax return if the actual value-added tax burden exceeds 3%, practically cutting tax costs for leasing companies. The circulation tax reform has already been generalized nationwide, and given the above-mentioned tax advantages, the number of companies that use leasing services is expected to further increase in the times ahead.

Lastly, the promotional measures by the government are also encouraging the development of the leasing industry. In March 2015, the Ministry of Commerce released a revised draft of the *Administrative Measures for Foreign Investment in the Leasing Industry*,⁵ which substantially deregulates the industry in terms of entry requirements and business scope, for the purpose of enhancing the sound development of the foreign-capital financing lease. The revised draft lowered the barrier to enter the leasing industry by removing the minimum capital requirement for establishing a foreign-capital leasing company or a leasing subsidiary and by allowing financing leasing companies to carry out factoring business as well. The revised draft also tightened the investor qualifications, aiming to contemplate the soundness of the industry by enhancing actual involvement of companies. Such movements are considered to be the outcome of the fact that the promotional measures for the leasing industry that used to be on a test run have become more commonplace nationwide.

⁵ 《外商投资租赁业管理办法》(商务部令 2005 年第 5 号) (Order of the Ministry of Commerce [2005] No. 5)

Comparison of leasing related policies in three major Free Trade Zones

While the leasing industry in China is under development as a whole, more preferential treatments have been introduced in the Free Trade Zones in Guangdong Province, Shanghai, and Tianjin as pilot and key areas. For the Guangdong Free Trade Zone, as can be seen from the promotional measures below (Fig. 3), the leasing industry is yet to develop compared to Shanghai and Tianjin. Nevertheless, within the year, the Qianhai authorities are planning to announce a more comprehensive set of preferential measures focused on the leasing industry. Such new measures and the active stance of the authorities, adding to the existing cross-border financing advantages, are bound to trigger a boom in the leasing industry of the region.

Fig. 3: Promotional measures for the leasing industry in the Free Trade Zones in Guangdong Province, Shanghai, and Tianjin (extract)

	Guangdong FTZ	Shanghai FTZ	Tianjin FTZ
Financing and Fund Management	<ul style="list-style-type: none"> RMB-denominated financing from financial institutions in Hong Kong and Macau is supported. Application for cross-border foreign currency financing through bond and stock issuance related to aircraft, ship and heavy industry machinery leasing projects is supported. 	<ul style="list-style-type: none"> If 50% or more of the fund for purchase of the lease property is financed with domestic loans or foreign bonds denominated in foreign currencies, the leasing fee can be collected in foreign currency (leaseback not permitted). 	<ul style="list-style-type: none"> Financing through the utilization of accounts receivable is supported.
Preferential Treatments	<ul style="list-style-type: none"> Financial support for capital increase or asset acquisition to financial leasing headquarters. Financial support for talents in the sector. 	<ul style="list-style-type: none"> Capital subsidy for newly established leasing companies in the FTZ. Financial support for the total amount of financing lease provided for companies in the FTZ. Financial support for purchase of large-scale lease properties. Financial support for talents in the sector. 	<ul style="list-style-type: none"> Capital subsidy for newly established leasing companies in the FTZ. Tax subsidy for newly established leasing companies in the FTZ (established within five years). Financial support for talents in the sector.

Source: Various laws and regulations, interview results with authorities

Business opportunities for foreign-owned leasing companies

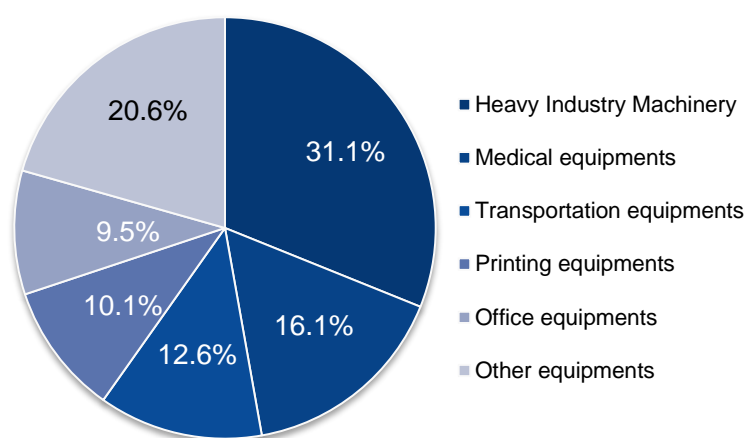
For many companies in China, finance leasing is still nothing more than a new and unfamiliar financing instrument. Generally, leasing volume accounts for 8–20% of total fixed-asset investment in developed countries, whereas it is only around 5%⁶ in China. Furthermore, leasing is mainly utilized by state-owned or large foreign companies and has not been widely applied by

⁶ 2014 Global Leasing Report, White Clarke Group

private companies. With the increase of domestic labor costs triggering more manufacturers to promote mechanization in recent years, demand for manufacturing equipment leasing is expected to serve the role as a leading force of the leasing market, which makes the exploration of the market worthwhile.

From the perspective of foreign-owned leasing companies, the main service areas in financing leasing are manufacturing equipments, transportation equipments, and medical equipments (Fig. 4). In particular, the leasing of automobiles and small medical equipments is attracting more attention in recent years.

Fig. 4: Breakdown of leasing properties by foreign-owned leasing companies (2014)



Source: *Report on the in-depth market analysis of the financing leasing industry in China* compiled by Askci Corporation

Demand for the leasing of medical equipments grew due to a lack of capital liquidity in the fast-expanding medical institutions. According to the statistics released by the China Medical Pharmaceutical Material Association, the volume of the leasing of medical equipment grew more than twice⁷ as much within the five years from 2009 to 2013, and it is expected to grow even further in the times ahead.

In the automobile financing sector, in the first place, automobile financing services in China as a whole are far less developed than those in developed countries, as can be shown by the mere 13% penetration rate compared to the 81% in the U.S.⁸ Under the current conditions, the main financing methods for automobiles consist of car loans provided by two types of financial institutions, banks and automobile financing companies majorly financed by automobile manufacturers⁹. However, the fact is that the existing

⁷ 中国医药物资协会医疗器械分会《2014 中国医疗器械行业发展状况蓝皮书》

⁸ 前海融资租赁俱乐部《汽车融资租赁成蓝海，体量惊人》，July 27, 2015

⁹ Automobile financial companies are non-banking financial institutions established with the ratification by the China Banking Regulatory Commission that specializes in providing financial services for purchasers and sellers of automobiles in China. Under current regulations, the major investor for an automobile financial company should always be an automobile manufacturer.

market, especially the enormous second-hand automobile consumption market, has not been thoroughly covered due to the restricted lending terms and conditions, etc of the aforesaid financial institutions. Given this situation, it can be said that there is great potential for automobile leasing to grow in the times ahead as a new form of financing tool.

Furthermore, for the medical equipment and automobile leasing sectors, there have been various support measures undertaken by the government, such as preferential treatment in the Tianjin Free Trade Zone, as previously mentioned. Though there are yet many issues to be resolved, such as the development of laws and regulations, it is believed that investments in the leasing business in such sectors are well-worth considering, in view of the current situation where financing has not caught up with the rapid economic and industrial development.

Up to now, many Japanese leasing companies are mainly engaged in providing services for Japanese enterprises. However, as the domestic market further matures, it is prospective to create new leasing markets as those mentioned above. As the environment that surrounds the financial market develops further, we shall expect a higher presence of leasing companies in the times ahead.

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