

# Identifying Factors for Success in the Chinese Equipment Leasing Market

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Lessors seeking expansion opportunities must consider the Chinese market, given its scope and its transition to a market-based economy. This is particularly true for larger lessors with ambitious growth goals. Even so, much of the infrastructure needed for a viable equipment leasing industry in China is not yet in place. As a result, it is critical that lessors be armed with adequate and accurate information regarding the opportunities and pitfalls in this market.

Many of the risks lessors face in China are the same as those in the United States, except that they are compounded by time and distance. There also are uniquely Chinese challenges that go beyond differing tax and accounting rules. For example, the legal rules have basic similarities, but the lack of adequate leasing law makes collecting past-due rents and repossessing equipment in China very difficult. Other major differences between the United States and China include language, culture, and the number and nature of business regulations.

Most international lessors with operations in China today have Chinese partners, due in part to the fact that a local partner was required to obtain a leasing license. With the recent availability of the wholly foreign-owned enterprise (WFOE) option and the new leasing law being considered, however, many large lessors are seeking to establish operations on their own. Smaller lessors, on the other hand, may continue to seek out partners, primarily due to the regulatory capital requirements.

Investing in the Chinese leasing market can be a sound decision for lessors whose customers are asking for leases there and who can effectively manage the risks. This investment, however, will require a significant and ongoing commitment. A sound exit strategy also should be a part of the

investment plan, keeping in mind that China is just as aggressive about keeping foreign equity investment from leaving the country as it is about bringing it in.

The key to success is to carefully consider the unique risks inherent in China. Although the analysis may not be much different than one performs in entering any new foreign market, it is important to remember that the differences in culture, economy, time, and distance magnify the risks, concerns, and operating issues.

There are several traditional reasons why United States lessors may seek to establish an international presence. Some follow their vendors or customers overseas, whereas others do so to support their parent's products. There also have been lessors, though few, which have done so as part of a market expansion strategy. This latter motivation is becoming more prevalent because of today's highly competitive U.S. leasing market.

Although it is true that the United States leads the world in the volume of equipment leasing,<sup>1</sup> it also is a mature industry. This maturity includes product commoditization, slowing growth, and static market share. Given this maturity, many U.S. lessors seek opportunities in new markets and channels to sustain asset growth and maintain profitability.

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## ESTABLISHING LEASING OPERATIONS OUTSIDE THE UNITED STATES

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Being a successful lessor is a challenge even in one's own country, but the task becomes even greater in another jurisdiction, especially when it is compounded by time and distance, such as in

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Equipment leasing in China is poised to become a major business opportunity for international lessors in the coming years. This article highlights the significant considerations for lessors interested in entering the Chinese market.

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China. There are many structural, legal, accounting, tax, and cultural differences that must be addressed.

According to *The Economist*,

At an operational level, doing business in China remains very challenging. Infrastructure has improved during the last few years, but remains deficient relative to demand. Restrictions on foreign firms in the manufacturing sector have been eased, but in the services sector they remain oppressive. Across the economic spectrum, skills shortages are severe and violation of intellectual property rights is rife.<sup>2</sup>

Beyond these factors, a U.S. lessor seeking to establish an international presence also must consider the developmental stage of the leasing industry it is entering. Many emerging leasing industries, for instance, follow similar developmental patterns. They start out small and then grow very rapidly as multiple lessors enter the market. After a relatively short period of growth and prosperity, however, there is an economic adjustment, usually in the form of a major contraction or in some cases a collapse.

A combination of government regulation and more rational business practices generally results in a subsequent period of slow growth, followed by a stabilization of the industry. It is at this point that the emerging leasing industry, strengthened by its trials, is poised to continue its development. The Indian, Korean, and Indonesian leasing industries, for example, followed similar patterns. By understanding this pattern, a U.S. investor can avoid losing hard-earned traction in that industry.

### Key Differences

On a more granular level, U.S. lessors must make decisions such as whether to act on a cross-border basis or to establish a permanent presence in the target market. Although a permanent presence generally proves to be the best formula for a sustainable strategy due to its operational flexibility, many issues need to be assessed to define the right structure.

A lessor operating internationally will face differing tax, accounting, and legal rules and regulations. These differences can be reduced to a set of common differences. As an example, although legal systems differ between countries, they generally may be classified as either common law or civil law systems. Common law systems are present in all former British colonies and protectorates such as Canada, India, and Australia. Civil law systems, on the other hand, are present in countries colonized or influenced by continental European cultures, such as Spain, Portugal, France, and Germany.

Accounting regulations are always an issue in any international expansion, but there is not much divergence in the accounting for leases between countries. Many countries now follow International Accounting Standard No. 17 (IAS 17) or a local lease accounting standard based on IAS 17 or FASB 13. And, although accounting systems still may be different, in line with the local legal systems and business cultures, there is a continuing trend toward unification.

The tax systems among the various countries of the world also share common threads. The particulars will differ, but each country has a tax on income, some form of cost recovery, and a tax on consumption. U.S. lessors nonetheless must be cognizant of the differences in application of the tax laws. Top managers of enterprises in China, for example, may be held criminally liable if the company's tax returns are deemed as concealing or evasive.<sup>3</sup>

Cultural differences also must be assessed and then addressed if the enterprise is to be successful. Special attention needs to be paid to languages, technological and physical environment, social organization, labor issues, country history, the concept of authority and political organization, religion, and even the prevailing business and social approach toward time. The many things that are taken for granted in the U.S. business environment now become critical factors for success in an international environment.

## CORE CHINA MARKET RESEARCH

A full understanding of the competitive landscape and unique challenges of a new market is the key to any successful expansion strategy. The balance of this paper addresses the factors to be considered and analyses to be performed by U.S. lessors contemplating conducting leasing business in China.

### Equipment Leasing in China

Before the legal and economic reforms of 1979, the central government and provinces undertook all capital investment in China. The first equipment leasing company, China Eastern Leasing Company Ltd., was not established until 1981.

During the early 1980s, China was in the initial stages of its migration from a centrally planned economy to a market-based one, which stimulated economic growth. Because most Chinese manufacturers lacked adequate capital, several new lessors were created to provide financing to these firms. Most of these leasing companies were joint ventures between Chinese and either Japanese or Korean lessors; Deutsche Leasing was also present. All of these lessors had their plans reviewed and approved by the Peoples' Bank of China (PBOC).

By the late 1980s and early 1990s, the Chinese economy had expanded significantly. This expansion also made new sources of funds available to Chinese manufacturers. This combination of equipment demand and the availability of financing, while creating opportunities, also created problems. For instance, many of the Sino-foreign lessors experienced severe liquidity problems, as lessees acquired new equipment and simply stopped making lease payments on their old equipment.

The lack of adequate leasing law and regulations made both collection of these past-due rents and repossession of the equipment very difficult for lessors. Many of the joint venture lessors, in particular, encountered difficulties

because they had interpreted the Bank of China's joint venture approvals as a tacit guarantee of enforcement of asset ownership and collection rights. This proved not to be the case; as a result, many lessors went out of business. According to Qiu Qiyang, senior advisor of the Financial Leasing Professional Committee, China Society of Finance, the Chinese government did eventually pay off a significant amount of debt owed to lessors in the early 1990s.<sup>4</sup>

Most European and North American multinationals began leasing operations in China during the mid-1990s. Due to the limited credit information available and questionable legal recourse in the event of default, these lessors tended to lease primarily to other creditworthy multinationals, as well as to a small number of the larger, better known Chinese companies.

Although the exact number of leasing companies is not known, it is estimated that China has over 10,000 small lessors, many or most of which are car rental companies. These lessors are in addition to the relatively small group of larger, well-capitalized lessors.

### Market Size

Data gathered by the Financial Leasing Committee of the China Society of Finance indicates that the total leased assets by leasing companies in China as of December 2003 was 21.36 billion renminbi (Rmb),<sup>5</sup> which is approximately US\$2.6 billion. This figure indicates a leasing penetration rate of 0.44% of capital formation,<sup>6</sup> which contrasts with the prevailing level of 30% in the United States. This indicates the tremendous growth potential of the Chinese leasing industry.

### Lease Taxation

Chinese companies, like many of their European counterparts, do not maintain separate books for tax and accounting. Taxes are paid based on revenues and income as declared in their statutory accounting books. There are four principal taxes that affect lessors and leasing transactions: income tax (see Table 1), business tax, stamp duty, and the value-added tax (VAT).

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Of these, the business tax, which is a tax on revenues announced on January 1, 1994,<sup>7</sup> is most problematical for lessors. This tax is assessed on the revenues arising out of the provision of services or the transfer of intangible and real properties. It applies to revenues generated by any enterprise with permanent establishment in China. The rate applicable to financial services is 5%, and it must be paid to the local tax authority.

The business tax is considered by the Chinese leasing industry as a major obstacle for the development of the industry. Although finance leases are not exempt from the business tax, it is applied only on the interest income, not on the entire payment, as in the operating lease. As a result, this tax unduly burdens the operating lease product and is, along with an undeveloped used equipment market, one of the main reasons operating leases have such a low acceptance in China.

#### Lease Accounting

In terms of accounting rules and standards, China has evolved from a centrally planned accounting system, put in place after 1949, to a comprehensive set of standards that tend to harmonize the Chinese standards with those of the International Accounting Standards Board.

China's Ministry of Finance (MOF) made several changes to Chinese accounting standards, in 1993 and again in 2000, in an effort to align China's accounting and reporting practices with global standards. Today, Chinese accounting standards recognize two types of leases, similar to most of the Western world. The classification of these lease types, referred to as financial and operating leases, is based on the economic substance of the transaction rather than its form. The Chinese accounting tests for operating leases are very similar to the FAS 13 and IAS 17 tests, although there are five tests rather than four (see Table 2).

#### Current Developments

After gaining membership in the World Trade Organization, the Chinese government undertook various commitments, including opening the financial services industry to direct foreign investment. In 2004, the National People's Congress started drafting a new leasing law that will eliminate the duplication of effort between CBRC and The Ministry of Commerce (MOFCOM). The new leasing law will authorize, regulate, and govern financial leasing operations.

An official draft of the law has been issued and currently is moving through a process of

Table 1

#### Income Tax Rates in China

	Income taxes		
	National	Local	Total
General rate	30%	3%	33%
	Tax holidays and incentives		
Production-oriented enterprises (must operate a minimum of 10 years)	100% tax exemption for the first two years and 50% exemption for the next three years (2 plus 3 rule)		
Reinvestment of foreign investor profits	Refund of 40% of the income tax paid on such reinvested profits		

Source: Dorsey & Whitney, LLP, "Doing Business in China 2004." [www.dorsey.com](http://www.dorsey.com).  
Table compiled by the Alta Group.

Table 2

**Comparison Between PRC Accounting for Leases and IAS 17**

Topic	PRC Accounting	IAS 17
Finance leases: classification	If the present value of the minimum lease payments amounts to substantially all of the carrying amount of the leased asset originally recorded in the books of the lessor, the lease should be classified as a finance lease.	A lease is classified as a finance lease if the present value of the minimum lease payments amounts to substantially all of the fair value of the asset.
Finance leases: recognition by lessees	Lessees should recognize finance leases as assets and liabilities in their balance sheets at amounts equal at the inception of the lease to the carrying amount of the leased property or, if lower, at the present value of the minimum lease payments.	Lessees should recognize finance leases as assets and liabilities in their balance sheets at amounts equal at the inception of the lease to the fair value of the leased property or, if lower, at the present value of the minimum lease payments.
Sale-leasebacks	Finance leases – Any difference between the sales proceeds and carrying amount of the asset is deferred and amortized as an adjustment to depreciation expense according to the depreciation pattern of the leased asset.	Finance leases: Any excess of the sales proceeds over the carrying amount of the asset is deferred and amortized over the lease term.
	Operating leases – Any difference between the sales proceeds and carrying amount of the asset is deferred and amortized in proportion to the lease payments during the lease term.	Operating leases: If the sales price is established at fair value, the profit is recognized immediately.  If the sales price is below fair value, the loss is recognized immediately. If the loss is compensated through future lease payments at below market price, the loss is deferred and amortized.  If the sales price is above fair value, the excess amount is deferred and amortized.

Source: "China's Accounting System Compared with the International Accounting System ([www.a-round.netfirms.com/data\\_resources%205.htm](http://www.a-round.netfirms.com/data_resources%205.htm)) and selection of data by the Alta Group.



There are two types of domestic leasing companies in China: financial leasing companies approved by the PBOC and other leasing companies—namely, those that do not need the approval of the PBOC.

comments and proposed changes. The draft of the law, revised to take into account comments gathered nationwide, will be submitted to the Finance and Economic Commission for review and discussion. The proposed new law contains the conditions for establishing a financial leasing company, along with the ongoing regulatory requirements for a financial leasing operation.

In addition, the financial leasing company measures set forth the framework for the PBOC to supervise and regulate the operation of financial leasing companies, foreign or domestic, as a special business. Further guidance is contained in numerous and scattered rules covering commercial, tax, accounting, and customs aspects.

#### ESTABLISHING A LEASING COMPANY IN CHINA

There is a clear distinction between the domestic and the foreign-owned leasing companies in China from a rules and regulations perspective. There are two types of domestic leasing companies in China: financial leasing companies approved by the PBOC and other leasing companies—namely, those that do not need the approval of the PBOC.

All foreign leasing companies in China are regulated by the government and, as such, must receive authorization to conduct business. Authorization to establish a foreign leasing company is obtained through MOFCOM. There are several structural alternatives available to foreign leasing companies, including representative offices, branches, joint ventures, and WFOEs.

Establishing a representative office allows the office to be a liaison between the foreign company and its Chinese clients. The representative office cannot perform profit-making activities such as executing sales contracts or directly billing customers.

China's Company Law,<sup>8</sup> which has been in

effect since July 1, 1994, permits the opening of branches by foreign companies, but, as a policy matter, China still restricts this entry approach to selected banks, insurance companies, and accounting and law firms. Although representative offices are given a registration certificate, branch offices obtain an actual operating or business license and can engage in profit-making activities. It should be noted that there are significant restrictions on the activities that representative and branch offices can conduct.

Joint ventures, another organizational option, can be formed as equity joint ventures, cooperative joint ventures, or foreign invested joint stock companies. The different joint venture forms are based on the amount and type of equity investment provided by the local and foreign partner. Historically, foreign companies were not allowed to own 100% of leasing companies in China, so joint ventures were very popular. Effective March 5, 2005, MOFCOM amended its existing rules by promulgating new measures regarding the administration of foreign investment in the leasing industry. These new rules effectively open up the leasing market to foreign investment by allowing WFOEs to operate as leasing companies. There currently are five leasing WFOEs in China: Caterpillar Financial, GE Capital, Hitachi Capital Leasing, Siemens Finance and Leasing, and Xerox Leasing.

#### Approvals and Time Required

As part of the regulatory process, an application must be filed with MOFCOM, accompanied by several documents, which are outlined in Table 3. MOFCOM at the central level shall, within 45 working days upon receipt of the relevant application materials, make a decision as to whether to grant approval. If approval is granted, it will issue a Certificate of Approval of Foreign Investment Enterprise. The investors whose applications have been rejected will be notified in writing with the reasons for the rejection stated therein. The exact application process and time frame under the new proposed law is not known at this time.

Table 3

**MOFCOM Application Documents**

▶ A feasibility study signed by all the investors
▶ The joint venture contract and/or the articles of association (a WFOE only needs its articles of association)
▶ A letter of creditworthiness issued by a bank
▶ Photocopies of the certificate of incorporation or commercial registry and/or identification of individuals acting as investors and/or legal representatives
▶ Audited reports of each investor, stamped by a certified public accountant
▶ List of names of the directors and letters of appointment for each director, signed by all investors
▶ Qualification certificates of the senior management staff
▶ The enterprise name pre-verification certificate
▶ All other documents required by the applicable law to the type of company selected

Lessors should sit down with the various regulators to go through and understand the licensing process. Once the process is understood, the lessor can complete the application, making certain to include all its potential future activities so as not to limit its scope of operations.

Source: Freshfields Bruckhaus Deringer, ed. *Doing Business in China* (Huntington, NY: Juris Publishing, 2004). Table by the Alta Group.

**RISK CONSIDERATIONS**

Any lessor seeking to establish a presence outside the United States must carefully consider the unique risks inherent in that jurisdiction. Although the analysis may not be much different than one performs in entering a new U.S. market, it is important to remember that the differences in culture, economy, time, and distance magnify the risks, concerns, and operating issues.

**Regulatory Issues**

Lessors in China are regulated by either the Ministry of Commerce (MOFCOM) or the China Bank Regulatory Commission (CBRC), depending on their license. These regulatory agencies may intervene, regulate, or otherwise restrict leasing companies' activities on different

grounds at any time. Because there is little or no education about leasing in certain areas, the resulting confusion or misunderstanding as to basic concepts may trigger unfair government actions or negative regulations.

CBRC, for example, is much more restrictive than MOFCOM as to reporting requirements and requires more paid-in capital. Lessors should sit down with the various regulators to go through and understand the licensing process. Once the process is understood, the lessor can complete the application, making certain to include all its potential future activities so as not to limit its scope of operations.

**Structure**

When considering structural alternatives, most lessors that have been through the process have considered paid-up capital requirements,

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reporting and regulatory requirements, the time to negotiate a joint venture agreement, and the advantages and disadvantages of having an equity partner when evaluating which structure is most appropriate.

Exit risks also should be an important element of the analysis. Joint ventures, although allowing foreign lessors to shorten the learning curve, also are more difficult to terminate, because they require the parties to work out satisfactory terms if the structure is unwound. Paid-in capital cannot be repatriated from a discontinued joint venture until the Chinese partner consents, and there have been several instances of negotiations dragging on for two or three years while negotiating satisfactory exit terms. If a lessor chooses a joint venture structure, a winding-up process should be documented in the partnership agreement to the extent that it is possible to do so.

### Staffing

Despite China's literate and generally well-educated workforce, staffing represents one of the biggest challenges for lessors in China. There is a dearth of experienced leasing personnel at all levels, from executive management to administrative staff. Most foreign lessors bring in expatriate management at the commencement of operations, then hire and train local management during the first two to three years of operations.

In addition, recruiting employees is regulated to the extent that it is mandatory to register the employees and report their recruitment in special files. Such personnel files keep track of almost every Chinese individual from a certain age. The personnel files system, although not as rigid as during the Cultural Revolution, is still important in many areas of Chinese life.

### Credit

When doing business with listed companies (which, generally, are only the larger companies in China) the best source of information can be found in a firm's filings with the stock exchange. Credit reporting agencies are still in their infancy in China, and the information they provide usually is not comparable with what is available

in Western countries. Because these reports are particularly expensive in China, lessors should assess whether the value of credit agency services is worth the cost.

Unfortunately, there is not a similar source of data for the smaller companies; in fact, there is hardly any publicly available data at all. Credit performance also, in many cases, is specific to each industry segment. The captives will have an advantage in this regard because they know their customers very well due to their dealer networks and time in the market. Independent lessors wishing to lease to the small-to-medium business segment will need to invest a significant amount of time studying the local market and, more importantly, developing personal customer relationships.

Compounding these issues is the fact that the habit to pay on time is the result of an educational process in which, for generations, individuals trade goods and services in free interchange markets. China started this economic environment in 1979, only one generation ago. Prior to that time, the Cultural Revolution adamantly ignored the value of binding obligations, so a transition to a payment culture should be expected.

### Residuals

Whereas residuals represent a primary risk for many lessors in the United States, the operating lease market in China has not developed to the level at which lessors are concerned with residuals, other than from a collateral perspective. Given that there is no tax efficiency, used equipment data, or even a secondary equipment market, Chinese lessors have not developed operating lease products to the levels found in the United States and Europe. Those lessors that are able to overcome the Chinese lessees' ownership mentality will have to develop a secondary market for their equipment.

### Legal and Documentation Issues

Anytime a new language is introduced into the business process there is an opportunity for a broader range of interpretation. Furthermore,



given that leasing is a relatively new concept in China, it is important to use local counsel. Other risk factors include:

- The recent adoption of contract law
- The language—in particular, the difficulty of interpretation of written characters
- The culture, especially concerning negotiation tactics

Although documentation can be used to differentiate a lessor from its competition, the market first needs to achieve a certain level of maturity before introducing innovative structures. Before combining elements of creativity in the transactions, for example, courts, other authorities, and businesses must be able to understand and navigate on a solid legal basis.

### Collections

The concept of paying over time, with repeated payments, is relatively new in China. Not only does this increase the risk of nonpayment by lessees but it also creates problems in the collection process. Collectors themselves may not understand the need and necessity to enforce the lease payment provisions.

There is a shortage of collectors with experience in China, making the staffing and training of this critical function a high priority. Furthermore, the rigor as to performance and metrics is not at the same level in China as it is in the United States and Europe, thereby compounding the staffing problem. Lessors will have to work very closely with local resources to understand the payment mind-set and find adequate collection staff.

### Repossession and Recourse

The enforceability of the lease agreement is a primary concern in China. The components necessary to enforce leasing transactions include the rule of law, the efficiency of the legal system, and a corruption-free environment. The first component, the rule of law, refers to the overall likelihood of prompt payments and voluntary repossessions, and is based on past practices and

recognition of the legal obligation to make payments.

The second factor to be considered is the efficiency of the court systems in China, particularly in connection with collection and repossession risks. If negotiations do not succeed, for whatever reason, going to court must be an effective alternative. Unfortunately, in China, the police and judiciary do not always understand leasing and its legal processes. The reality is that going to court is not necessarily an efficient alternative for enforcing the lessor's rights, particularly in smaller cities and locales.

When it comes to bankruptcy, the law does not contemplate any restructuring processes such as in the U.S. Bankruptcy Code. Furthermore, there is not yet an effective test as to whether Chinese bankruptcy courts and liquidators will accept the preferential range of lessor's rights in bankruptcy proceedings. This fact creates additional legal risk for lessors.

On the positive side, China currently is committed to the International Monetary Fund and WTO to reform its insolvency law. For the time being, however, lessors are best served by avoiding involvement in bankruptcy proceedings.

### Exit Strategy Risk

The process of ceasing operations in China is similar to that in most other countries. This process involves filing documents with the appropriate government authorities, submitting audited financial statements and bank records, settling with partners, and paying any debts and taxes due. The process, however, moves much more slowly in China than it does in the West.<sup>9</sup>

China aggressively pursues foreign equity investment in the country, and it is equally aggressive about keeping as much of this equity in the country as possible. Lessors considering establishing an onshore entity should be aware that, if operations are not successful, repatriating their investment is likely to take longer than it will in Western countries.

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Equipment leasing in China is alive, growing, and poised to become a major business opportunity for international lessors in the coming years, despite a number of significant risks that must be managed to be successful in the market.

Under the old joint venture structure, it is difficult to take equity out of China in the event circumstances or strategies change. The only option for the foreign lessor to recoup its equity is to sell its shares to a new buyer. The selling process, however, takes months to complete, because the Chinese partner has a "right of first refusal" to buy the foreign shares and, in most cases, finds ways to block the sale. It took GE three years, for example, to get agreement from its Chinese shareholder to sell Daye Leasing. CIT's experience is another good example of the delays inherent in this process.

The new regulations issued in March 2005, allowing 100% foreign-owned lessors, will reduce the exit risk for lessors. Under the new law, a foreign lessor can spell out in its application the conditions under which it can terminate its leasing operation. It is also easier for the foreign lessor to find a buyer to take over the 100% owned entity.

If the leasing entity is dissolved, the foreign lessor must apply for capital repatriation from the State Administration for Foreign Exchange (SAFE), although, since China has over US\$600 billion in foreign reserves, it is unlikely that SAFE will block the application. If the leasing entity is sold, the purchase price can be settled outside China without SAFE approval. This combination of the new regulations and the large China foreign reserves help mitigate the lessor's exit risk.

### CASE STUDIES

Detailed interviews were conducted with five separate lessors in an effort to learn more about the realities of equipment leasing in China. These lessors are either active in, or seriously considering entering, the Chinese equipment leasing market.

Diverse lessors were incorporated as part of the case studies to glean a variety of experiences, and included:

- A WFOE captive lessor whose parent is a large, U.S.-based manufacturer of industrial equipment
- An international technology company whose China leasing activities are conducted by a joint venture leasing company with a Chinese lessor partner
- A Hong Kong-based bank that writes offshore leases into China
- A local Chinese-owned lessor
- An international bank-owned equipment lessor that has studied the Chinese equipment leasing market carefully but, as of the time of this writing, has chosen not to enter the market

### Case Study Conclusions

Equipment leasing in China is alive, growing, and poised to become a major business opportunity for international lessors in the coming years, despite a number of significant risks that must be managed to be successful in the market. To be sure, China poses a number of significant risks that must be managed to be successful in the market. There also is much market development activity to be done before leasing is accepted as a mainstream financial product by Chinese businesses.

The following are significant factors that should be useful to lessors considering entering the Chinese market.

***The key driver for market entry, for most non-Chinese lessors studied, has been the need to support their existing customers.*** China's rapid economic expansion has drawn many firms across a variety of industries to establish onshore operations in China, and these firms increasingly need financing solutions for their customers and themselves. It should not be assumed that a "build it and they will come" approach will work in the Chinese leasing market, though. Foreign lessors without a customer-driven need for equipment leasing in China probably should not consider entering the market at this time.

***There is no single, successful business model.***

Leasing companies analyzed in this study include WFOEs, joint ventures, offshore and Chinese-owned onshore lessors, each of which is successful in its own way (although the subject of the WFOE case study in this paper is still in the early days of its existence). Partnerships with Chinese lessors can shorten the time to market and help lessors get assimilated into China more quickly, but it can be difficult to find a suitable partner: financial strength, control issues, cultural differences, and a lengthy approval process often are obstacles. Based on past and current lessors' experiences, it appears that most Western mid- and large-size lessors will view a WFOE license as their favored vehicle to enter the market.

***Identifying and managing the risks of doing business in China is the critical factor to success, but the task should not be overwhelming.***

Many prospective market entrants that were interviewed for this paper simply rolled their eyes when asked about the risks of doing business in China. "The risks are way too big for us to even consider going there" was a typical response.

There is no question that the credit and legal environment in China is extremely challenging, the regulatory process is burdensome, and the tax system discourages operating leases. However, there also is no question that the environment is gradually improving, with dozens of lessors already on the ground and doing business successfully.

Problems such as these are common in many countries, however, and are being successfully managed. They simply need to be identified, quantified, and addressed through well-designed, closely monitored business processes. For example, many lessors view the lack of sufficient credit information as ample reason to avoid China, yet all the lessors interviewed indicated their loss experience in the country was about what they had expected and built into their pricing.

Other interviewees view the unclear recourse process as a showstopper, but the experience of in-country lessors is that they avoid going to court by structuring transactions conservatively,

carefully screening their lessees, and knowing their customers. Yes, these processes will result in lower leasing volumes initially, but as conditions in China change and lessors gain more experience, it is likely that volumes will gradually increase without an accompanying increase in bad debt. The key is for lessors to manage their risk-related processes effectively.

***The lack of trained local personnel should be factored into the business plans.***

All lessors interviewed, both foreign and domestic, are acutely aware of the dearth of bilingual (Chinese-English speaking) leasing talent in China. Lessors entering the market should have a carefully vetted hiring plan and be prepared to provide in-depth training to their local hires.

***Leasing is still a new concept for many businesspeople in China.***

All foreign lessors interviewed commented on the surprisingly low level of understanding that businesspeople, including vendors and resellers, have about leasing. This issue can be overcome with sufficient marketing and training, but lessors should not underestimate the effort involved.

***The used equipment market is largely undeveloped but could be a huge opportunity for certain assets.***

Anecdotal evidence from interviewees indicates that there may be a very large, as-yet-untapped market for used IT assets. If the government enacts incentives to promote the use of used equipment, the demand could rise quickly and lessors could be among the key beneficiaries. Other assets may face asset-specific barriers, such as a reluctance to buy used industrial equipment when consumers are unfamiliar with high-quality equipment that does not fall apart after two years. Without tax or other government incentives, the used equipment market in China for most assets will continue to evolve slowly.

As a final note, lessors should plan on every part of the process taking longer than anticipated in China. Both Chinese and foreign lessors have found, through painful experience, that tasks requiring government approval simply take a long time. Interviewees recounted stories of

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waiting several months just to get a simple document signed and approved. Equally frustrating is the lack of willingness of many government officials to commit their opinions or rulings to writing. There is an old adage regarding vacations that suggests, "Always bring twice the money you think you will need." The same concept as it applies to lessors entering the China market is, "Always plan for twice the time you think you will need."

### Acknowledgments

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### Endnotes

1. The United States originates 40.65% of the global leasing volume worldwide, according to the World Leasing Yearbook 2005.
2. "Coming of Age: Multinational Companies in China" (white paper), Economist Intelligence Unit, June 2004. [www.eiu.com](http://www.eiu.com) or [www.kpmg.de/library/pdf/050816\\_MNCs\\_report\\_en.pdf](http://www.kpmg.de/library/pdf/050816_MNCs_report_en.pdf).
3. Article 201 of the People's Republic of China Criminal Law, as amended in March 1997.
4. Wang Pei, "Leasing Sector: Financial Leasing on the Rise," Cityweekend.com (Beijing Ringier International Advertising Co.), June 2005.
5. The renminbi is the Chinese currency.
6. This number does not include hire-purchase agreements. Including hire-purchase transactions would push the rate closer to 40%.
7. Provisional Regulations of the PRC on Business Tax, adopted by the State Council on Nov. 26, 1993, promulgated by the State Council on Dec. 13, 1993, and effective Jan. 1, 1994.
8. The first PRC Company Law was adopted by the Standing Committee of the National People's Congress on Dec. 29, 1993. It was effective July 1, 1994 and was amended Dec. 25, 1999.
9. The story of the Five Stars Brewery as recounted in *Mr. China*, by Tim Clissold (HarperCollins, 2005), provides a real-life illustration of how an exit strategy, motivated by the decision to leave the country, was handled.



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