

# LEASING : A WAY OF INNOVATING EQUIPMENT AND MODERNIZING TECHNOLOGY

by HỒ DIỆU & PHẠM PHÚ QUỐC

**S**tudying ways of forming and using capital in developed countries and applying them selectively and creatively to Vietnam economy are becoming current problems responding to requisite for "mobilizing and using capital effectively" in order to modernize and industrialize the economy. This article is also on these problems.

## 1. Current ways of financing innovation of equipment and technology in Vietnam

At the present, innovation of equipment and technology is a matter of great urgency in Vietnam enterprises. Besides lack of capital, outdated equipment and technology is one of the main causes of failure of Vietnam enterprises in international markets.

In other countries, when the equipment is worn out at 70%, it will be innovated, whereas in Vietnam, in many factories, the equipment was even worn out totally without replacement. The equipment in the whole country was worn out at 53.9% on average according to experts' estimation. This percentage is trending upwards because outlay for replacement cost is lower than annual amortization. For example in HCMC in 1993, investment in fixed assets represented from 9 to 12%, whereas amortization occupied from 11 to 12%. Technically, the equipment in Vietnam is four or five generations older than that of other countries, modern equipment in Vietnam occupied only 10%. Moreover, our existing machines and equipment aren't uniform. The percentage of uniformity in central industry (industries managed by central authorities) is 34% and local industry 27%.



In such a situation, our local products are poor in both quality and quantity. We used to say that due to contraband goods which evaded taxes, the local products can't compete against them successfully. It's only a half-truth. In fact, our products can't compete with foreign products because our machines and equipment are too outdated.

So we have to innovate equipment and modernize technology of our industry. If this isn't done soon, we will not be able to keep the economy stable or realize other targets.

Recently, investment in innovation of equipment and technology in Vietnam found itself in a difficult situation. There are many limits in capital sources and ways of financing:

- Financing by the national budget:

In the multi-sectoral market

economy, the national budget can't finance enterprises as it did in the old mechanism but it has to cover expenditures on administrative management, national defense, cultural and social activities and investment in infrastructure building in order to help enterprises operate favorably. So the financing of the national budget to enterprises is very limited.

- Self-financing of enterprises.

The efficiency of most of state enterprises is of low or medium level, therefore their reinvestment is small. As for private enterprises, most of them are newly-built, so their retained profit isn't big enough to reinvest.

- Financing by money market

This potentiality is big but isn't tapped because there is no stock market in Vietnam and other financial institutions which haven't fully developed yet. Moreover, the public hasn't been in the habit of investing in the money market.

This way of financing will develop in the coming years but only at a moderate speed.

- Financing in financial institutions

In the old mechanism, state banks supplied large part of short-term loans, while long-term loans were from the national budget. After changing to market mechanism, the state banks have provided short and medium-term loans, although these loans represented only a small percentage in bank deposits. However, it's was a good progress when the short and medium-term loans granted by the banks in 1993 doubled in comparison with 1992.

In order to meet the need for technical innovation, we have to diversify the ways of financing. Although the way of providing short and medium-term loans has many advantages now,





but it can't cope with any situation, besides, there are many circumstances in which the banks can't grant loans:

- One of the basic conditions for being granted long or medium loans by the banks is the business was considered as healthy, that is, the business is making profits and earned prestige in doing business with the banks in the past.

By this standard, most of state enterprises can't be granted long or medium loans. As for newly-built private enterprises, they haven't got enough time to win trust of the bank.

As for businesses considered as unhealthy, the bank insists on collateral for loans, and the value of collateral security must be bigger than loan by 20%. In point of fact, most of fixed assets of enterprises were outdated and they have nothing to give as collateral security. Moreover, these assets should be mortgaged for working capital which is also an urgent matter to businesses.

A matter of principle with the bank to limit risk degree in granting long or medium loans is the business should contribute from 30% to 50% of project value (or investment goods). As for businesses who haven't accumulated a considerable retained profit, they can't borrow long or medium loans from the banks. On the other hand, according to recent regulation of Ministry of Finance, the newly-formed state enterprises would receive only 30% of working capital approved by the government. Therefore, these enterprises have to change their profit into working capital and nothing remains for them to contribute to investment project and get long or medium loans from the bank.

For the said limits, we have to diversify ways of financing in order to protect financial organizations from

risks and at the same time, to form a well-operated financing mechanism. Leasing is one of the effective ways of financing needed application to Vietnam.

## 2. Financing by leasing and supporting policies in the coming years

For the time being, leasing activities would be assigned to the banks, because their range of business is wide and they have got close relations with various industries. This is a basis for risk distribution, increasing business efficiency and providing best service for the customers.

On the other hand, we should create conditions favorable for formation of independent leasing companies with a view to diversifying and specializing this industry. In order to realize this, the government had better allow to form leasing companies sponsored by a bank or banks. After that, these companies will be specialized and the banks will help them distribute risks. The distribution of risks will be done directly or indirectly. When leasing companies are sponsored by banks, their capital will be supported by signing leasing contracts, providing guarantee about issuing long or medium bonds...

- Policies on supporting leasing business

Industrialization and modernization are both task and need of the economy, therefore the government should make supporting policies in order to encourage forming and developing leasing business. Giving preferential taxes is one of most effective policies.

Moreover, leasing business requires a big starting capital. Without preferential taxation, the cost of doing this business will go high and limit the development of this business.

According to the plan operating

leasing business in Vietnam sponsored by IFC, the import tax on imported equipment for lease would be reduced. In our opinion, this preferential treatment has the following weaknesses:

+ Foreign experience showed that there are three participants in leasing business: lessor, lessee and equipment supplier. If this pattern of leasing business is applied to the Vietnam economy, the equipment for lease will be imported by commercial companies, and these companies import both equipment for lease and equipment for sale. When the government's management wasn't good and corruption is widespread in Vietnam today, the equipment imported for sale will be declared as equipment for lease in order to avoid tax. This way of doing business will cause damage to the national budget.

+ Exempting equipment for lease from import tax will make difference in price between cash-paying equipment and equipment for lease. This situation will not encourage reinvestment.

In our opinion, in order to encourage leasing business, the government had better reduce sales tax and income tax on leasing companies.

Besides preferential tax, the Central State Bank could be a guarantee of leasing companies for loans from foreign banks, or borrow foreign loans of long or medium-term for leasing companies, or finance leasing agreement which will expire under a year...

Leasing is a new way of financing and applying it to Vietnam isn't a simple matter. In order to make it a popular way of financing, the favorable policies and measures should be taken by the government, the businesses should be informed widely about this way so they can accept it ♣