

## ECONOMIC IMPACT OF LEASING RELATIONS IN SMALL BUSINESS ENTITIES

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### Abstract

This article deals with the important information about economic impact of leasing relations in small business entities. On the other hand, classification of Leasing transactions and its special features were noted.

**Keywords:** bank financing, economic recovery, Conventional bank, business operations, financial literature, market imperfection, asymmetric information.

### Introduction

The ability of SMEs to access finance is important for funding business investment, ensuring businesses reach their growth potential, and for facilitating new business start-ups; a lack of finance can constrain cash flow and hamper businesses' survival prospects. Typically, SMEs are not able to raise money directly in the capital markets and are therefore - with regard to external sources - mainly dependent on traditional bank financing, which is itself limited by constraints due to banks' refinancing capacity, their risk appetite and capital adequacy. Many parameters are currently impacting the lending behavior of European banks, among them are the ongoing sovereign crisis, upcoming adjustments of the regulatory framework, and an only fragile economic recovery. Banks respond to the difficult market environment with deleveraging, building up liquidity, paring down risk assets and tightening of credit standards.

Leasing is referred to as asset based financing. As lessors retain ownership of the assets they lease throughout the life of the contract, these leased assets are therefore an inherent form of collateral in such contracts (compared to traditional bank lending which will either be unsecured or make use of different types of collateral and typically not physical assets such as equipment which are inherent in leases). Conventional bank lending focuses on the loan repayment by the borrower from two sources: a primary source, the cash flow generation, and a secondary source, credit enhancements and collateral. Leasing is focused on the lessee's ability to generate cash flows from the business operations to service the lease payments, as the lessor retains legal ownership of the asset[1]. Hence, leasing separates the legal ownership of an asset from its economic use. Ownership of the asset may

or may not pass to the customer at the end of the lease contract. Contracts, where legal ownership of the asset passes directly to the customer at the start of the agreement, are not considered to be leases. Leasing is often seen as substitute for medium to long term credit, but the answer to the question whether leasing and debt are substitutes or complements<sup>6</sup> is not trivial and has in financial literature not resulted in a clear conclusion. In traditional corporate finance the decision of buying versus leasing is mostly discussed in the context of the Modigliani and Miller world of perfect capital markets (where in general the capital structure is irrelevant for the determination of the firm value). But in real financial markets, there are market imperfections. In the area of access to finance for SMEs, a market imperfection/failure is not only present during a deep recession or a financial crisis but also on an on-going basis as a fundamental structural issue. The reasons for a market failure relate to insufficient supply of capital (debt or equity) and inadequacies on the demand side. This market failure is mainly based on asymmetric information (in the case of debt: information gap between lender and borrower), combined with uncertainty, which causes agency problems that affect debt providers' behavior[2].

The development of entrepreneurship is associated with undertaking numerous proactive, dynamic activities, most often of an innovative or investment character, targeted at creation of something different with regards to value, at the same time sacrificing time, efforts and resources and taking into account the accompanying financial, psychological and social risk. In the process of entrepreneurship what becomes very crucial is ensuring that necessary resources(including first and foremost financial ones) needed to implement one's assumed idea are available. This is the problem in particular observed in micro, small and medium-sized enterprises, which due to their resource shortages must very often make use of external sources of funding for their entrepreneurial activities. Despite the substantial number of possibilities for choosing such a source, SME sector companies struggle with the phenomenon of credit mentality and with the barriers in accessing selected instruments of funding. On the other hand it is the access to and ability to make use of external funding that determines to a great extent the entrepreneurial activities of micro, small and medium-sized enterprises. One of the sources of funding becoming more and more common for entrepreneurial activities of the companies within the SME sector is leasing. Its nature is the use of a defined material good, for a specific charge by a company (lessee), without the necessity of its direct purchase from the lessor. The object of leasing may be both movable and immovable goods, and one can distinguish several common characteristics applicable to leasing transactions.

Leasing transactions can be classified in a variety of ways, applying various criteria of division. Among the examples one can list the following:

1. The number of entities, which is the basis for division into direct leasing, indirect leasing and leaseback.
2. The duration of the contract, which is the basis for division into short-term leasing, medium-term leasing and long-term leasing.
3. The obligations of the parties involved and the parties being burdened with additional input. In this case one can distinguish net leasing and full leasing.
4. The scope of additional services, taking these into account one can distinguish wet lease and dry lease.
5. The scope in terms of territory, which allows to distinguish national and international leasing.

6. The entity financing the purchase of the good. One can distinguish manufacturer's leasing (direct) and lease by a leasing company (indirect).

7. The method of issuing foreign currency payments, allowing one to distinguish leasing in Polish zlotys and foreign currency leasing.

To sum up all given facts above it should be noted that leasing has many important functions in the economic practice. First of all it is a financing instrument suitable for a number of investment needs of a company, with the minimum engagement of own funds and substantial, one-off investment expenses. It supports the development of entrepreneurial attitudes and activities by increasing the flexibility of actions, innovativeness and competitiveness of the enterprise. It positively influences the financial liquidity and does not result in increase of company's liabilities, hence it does not restrict access to other forms of financing. It is also beneficial from the point of view of the balance sheet and taxes, due to the direct translation of all or part of the leasing rates to tax deductible expenses.

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