EQUIPMENT LEASING NEWSLETTER

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Update: The China Equipment Leasing Market

By Jonathan L. Fales

The 10th annual China Leasing Summit, conducted by Duxes Information and Technology PLC was held June 8-9, 2017, in Beijing. As in past years, the summit included speakers from the Chinese equipment leasing industry, government officials, academics, and officials from various Chinese leasing associations.

This year's summit differed from past ones, however, as many attendees concluded that the industry is approaching an inflection point. Equipment leasing in China is highly fragmented, and, unlike most other regions of the world, there is no single association that speaks on behalf of the industry as a whole. As the Chinese government tightly regulates leasing, it is problematic that the industry has never been able to develop a unified position on important licensing, tax, capitalization, regulatory and other requirements. This needs to change if the industry is to continue to expand, particularly among small and medium enterprises.

China Leasing Volumes

Less than five years ago, it was difficult to find consolidated equipment financing industry volumes for China. The Tianjin Leasing Association, under the direction of Yang Haitian, undertook the effort to compile statistics beginning in 2013, and over the years has obtained the active participation of most of the larger lessors in China.

Reported 2016 industry volumes were RMB 5.33 trillion, or approximately US$852.8 billion, as shown in Table 1 below.

Table 1: China Enterprise Equipment Finance Volume Originations in 2016 (RMB 100 million)

	Total Business Volume at the end of 2016	Total Business Volume at the end of 2015	Increase	Growth rate (%)	Business Proportion (%)
Financial Leasing	20,400	17,300	3,100	17.9	38.3
Domestic Leasing	16,200	13,000	3,200	24.6	30.4
Foreign-Funded Leasing	16,700	14,100	2,600	18.4	31.3
Total	53,300	44,400	8,900	20.0	100.0

Data source: China Leasing Alliance and Tianjin Binhai Finance Lease Research Institute

These figures may require some explanation for those more familiar with annual financing volumes published by the U.S.-based Equipment Leasing and Finance Association (ELFA). First, lessors in China today are categorized more frequently by the type of government-issued leasing license they use than by the nature of the business they underwrite. So:

- Financial Leasing companies typically are large, Chinese bank-owned lessors that write large-ticket transactions, such as aircraft, shipping, and infrastructure-related financing structures. These lessors are licensed by the China Bank Regulatory Commission (CBRC).
- Domestic Leasing companies refers to lessors that usually are specially licensed within government-decreed Free Trade Zones, such as those in Shenzhen (established in 1996 to promote technology and other industries) and Tianjin (established in 2015, primarily to facilitate growth of the transportation industry).
- Foreign-Funded Leasing companies cover a wide range of lessors, most of which are licensed by the Ministry of Commerce (MOFCOM). The majority of international captive lessors, many international bank lessors, and nearly all small lessors operate under licenses issued by MOFCOM.

Second, the leasing volumes include a large number of sale-leasebacks, particularly among smaller lessors. Thousands of small lessors were established over the last five years for the sole purpose of providing sale-leaseback financing to small- and mid-sized companies unable to obtain traditional bank financing. While it is difficult to do a true apples-to-apples comparison with the U.S. market, it is safe to assume that a significant percentage — some estimates are 90% or higher — actually are sale-leasebacks. Still, China is home to a sizable volume of equipment financing that is easily in the high tens to over one hundred billion dollars annually.

Market Segmentation

Jiang Zhongquin, a semi-retired veteran of the China leasing industry and an important spokesperson for issues concerning it, has been a regular speaker at past China Leasing Summits. Jiang spearheaded the successful, multi-year effort to eliminate a provision in the tax code that penalized underwriters of operating leases in China, and operating lease volumes have increased substantially since.

At this year's summit, Jiang observed that China is unlike other developed countries in the way its leasing industry has developed. Today, most countries either have no licensing requirements or, at most, a single entity that can issue leasing licenses. China has multiple issuing entities — CBRC, the Free Trade Zones, MOFCOM — each with different regulations regarding capitalization, reporting, tax incentives, and financing products that can be offered. It is not surprising that a China-wide leasing association has not emerged yet to speak for such diverse interests.

Table 2 below contains the number of registered Chinese lessors, by license type, as of June 2017.

Table 2: Chinese Leasing Industry Enterprise Growth, First Half of 2017

	Number of Enterprises at the end of June 2017	Number of Enterprises at the end of 2016	Increasing	Growth rate (%)	Number of Enterprises at the end of June 2016	Increasing	Growth rate (%)
Financial Leasing	66	59	7	11.9	52	14	26.9
Domestic Leasing	224	205	19	9.3	190	34	17.9
Foreign-Funded Leasing	7,927	6,872	1055	15.4	5466	2461	45.0
Total	8.217	7,136	1081	15.1	5708	2509	44.0

Data source: China Leasing Alliance and Tianjin Binhai Finance Lease Research Institute

Parenthetically, it should be noted that as an illustration of how it is still “early days” in measuring China’s equipment financing industry, an uncited MOFCOM estimate of leasing companies at the end of 2016 is 6,158, some 978 fewer companies than the 7,136 estimate presented here.

Jiang observed that China’s leasing industry has grown steadily over the years, which is reflective of China as a whole, but that future growth will be hindered if the various segments fail to coalesce.

One important issue is the availability of credit information. Culturally, it is not unusual for smaller, family-run companies to maintain multiple sets of financial statements, which makes it difficult for lessors to make lending decisions unless the lessor has close (and usually local) knowledge of the business. This has severely impeded the availability of credit to smaller companies.

In 2006, the CBRC created a credit registry for banks to record and share credit information on borrowers. The registry has proved useful to bank lenders and lessors — but, unfortunately, only for bank lenders and lessors — as use is restricted to institutions licensed by the CBRC. Thus, only 8% of all registered Chinese leasing companies have access to this information. Lack of a common leasing association representing all lessors means there is no entity working with the government to change this.

Another problem is funding. Capitalization requirements range from RMB 100 million for a CBRC license to RMB 10 million for a MOFCOM license. Non-Chinese-licensed entities are required to source debt from Chinese banks, but the availability, cost, and amount of funds traditionally has been dictated at the beginning of each quarter by the CBRC. The syndication and securitization markets are therefore difficult to access for small and mid-sized lessors in China. Needless to say, this makes capital planning and customer support difficult. Lessors have complained about these challenges for years but have been unable to make much progress with the Ministry of Finance. A single Chinese leasing association would at least give a unified voice to the industry, and to possible solutions.

Impact from Fintechs

Peer-to-peer financial technology companies, or Fintechs, are beginning to make a splash in the financing industry in China. So far, their impact has been primarily on bank-related consumer business, but this is growing quickly into the small- and medium-sized business sector.

Josh Ye, writing in the *South China Morning Post* on Aug. 9, 2017, noted the impact Fintech firms already have in the banking industry:

“Speaking before a crowd of hundreds at the Rise Conference in Hong Kong last month, Jing Ulrich, vice chairman Asia Pacific at JPMorgan Chase, heaped praise on the two Chinese online payment juggernauts, Alibaba Group’s Alipay and Tencent’s Tenpay.

‘JPMorgan, every year, as we speak, processes through our QuickPay 94 million payments,’ he said, ‘But Tencent, the Chinese company, over Chinese New Year, in five days processed 46 billion payments. Basically that means 800 million payments per hour.

‘Visa has a maximum capacity of processing 25,000 payments per second. But Alipay can process 50,000 payments, twice as much, per second.’” *See* Big Banks on Notice That They’re Losing Ground to China’s Fintech Giants. Josh Ye, *South China Morning Post,*http://bit.ly/2vHFhJr.

Will Fintechs have an impact on the equipment financing industry? Almost certainly, yes. In a November 2016 white paper published by DBS Bank of Singapore and EY, the authors state:

With high levels of internet and mobile penetration, China is already the world's largest and most developed retail e-commerce market, accounting for 47% of global digital retail sales — the result of a massive domestic retail market in a closed digital economy. Now, these digitally savvy Chinese consumers, who have few reservations about sharing personal information, are ready to embrace FinTech offerings, creating opportunities for FinTech firms and incumbents willing to take on digital transformation. These opportunities will come initially from the under-banked or unbanked populations of small and medium enterprises (SMEs) and consumers with unmet needs.

The Rise of FinTech in China: Redefining Financial Services. A collaborative report by DBS and EY, November 2016, https://go.ey.com/2hemdZt.

Interestingly, Fintechs should have little trouble entering the Chinese small-ticket equipment financing market:

- The market is largely unpenetrated by lessors, given the lack of availability of credit information.
- Operating leases, which became common among large-ticket lessors following business tax reform, are essentially non-existent in China for small-and mid-ticket leasing. Residual-based leases would be harder for Fintechs to transact quickly today, but loans already are THE core Fintech offering — and dollar-out finance leases are nearly identical to loans structurally.
- The lack of operating leases in China has led to the retarded development of a used equipment market for most assets. Therefore, the demand for residual-based financing transactions does not exist among small-ticket lessors today.

How will the emergence of Fintechs affect the Chinese equipment leasing market? While it's too early to say with certainty, it's not hard to imagine the entire small- and mid-ticket leasing market being captured and dominated by Chinese Fintechs within a few years. Existing lessors would then be forced to adopt new technology and processes to compete with Fintechs or move to larger-ticket/residual-based leasing … or go out of business.

Conclusion

Following the 2017 China Leasing Summit, several lessors remained in the auditorium to discuss the state of the industry going forward. Some voiced frustration that progress on tax policy has moved so slowly; others lamented the inability for MOFCOM-licensed lessors to obtain the same quality of credit information as CBRC-licensed bank lessors. All agreed that the time has come for the industry to consolidate its various factions and develop a way to speak with a unified voice to the Chinese government ministries that oversee leasing, primarily the Ministry of Finance and Ministry of Commerce.

An effort to do so has been revived by some Chinese equipment financing industry veterans. These leaders have begun efforts to contact the heads of other Chinese leasing associations for the purpose of developing an entity that represents the common interests of Chinese lessors. Prior attempts to do so were unsuccessful given the disparate interests of the various associations; perhaps this group will succeed.

In either case, the face of the Chinese leasing industry is about to change. If a unified leasing association is created with the aim of representing all facets of the industry in constructive talks with government ministries, the pace of equipment financing growth is likely to accelerate.

Otherwise, a disjointed industry may well morph into two groups: big-ticket/CBRC-licensed lessors in one corner; and everyone else — with Fintechs playing a major role — in the other. The 2018 China Leasing Summit should prove to be quite interesting.

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