OXFORD ECONOMICS

# The Use of Leasing Amongst European SMEs

## Executive Summary

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# Executive Summary

This report, written by Oxford Economics for Leaseurope, the federation representing the European leasing industry, examines to what extent, how and why Europe's small and medium sized enterprises (SMEs) use leasing.

Leasing is a contractual agreement where a leasing company (lessor) makes an asset it owns available for use by another party (a lessee), for a certain period of time and in exchange for payment.

Our report aims to quantify SME's use of the various forms of leasing that exist in Europe and, as such, establishes an evidence base to help policymakers and stakeholders in the SME finance sphere understand the important role leasing plays in financing European SME investment.

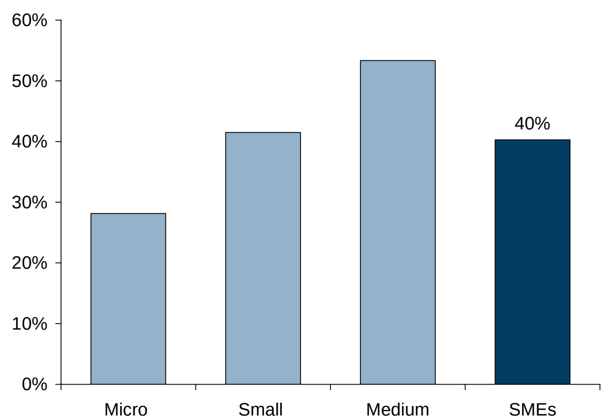
The report is based on a survey of the use of leasing amongst European SMEs conducted in July 2011. Our survey partners, EFG International, interviewed just under 3,000 SMEs across 8 countries (Germany, France, UK, Italy, Spain, Netherlands, Poland and Sweden – which together account for 83% of total EU economic output and 78% of the European leasing market) and 9 industrial sectors.

## European SMEs' use of leasing

Of the SMEs surveyed, 40% used leasing in 2010. This is expected to increase to 43% in 2011.

Broken down by SME size, 28% of micro firms used leasing, compared to 42% of small firms and 53% of medium sized firms. This is in line with other evidence that micro firms make less use of external sources of finance than small and medium firms.

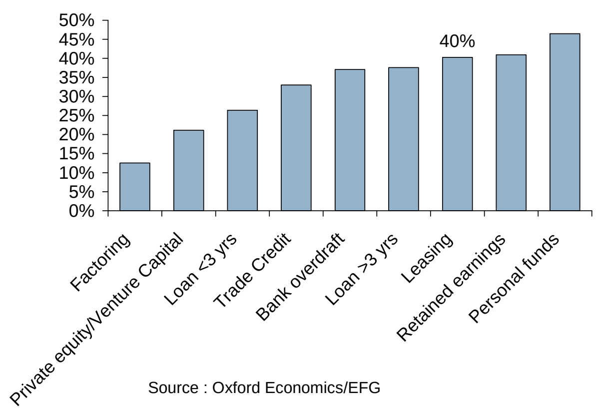
**Proportion of firms using leasing, 2010**




Source : Oxford Economics/EFG

**Investment by funding type, all SMEs**

Percent of firms using finance type in 2010



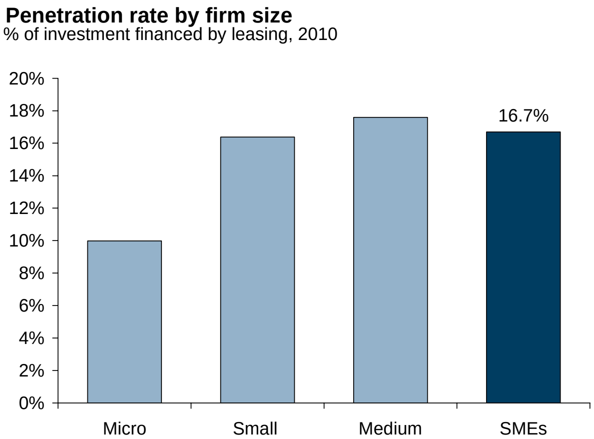

Source : Oxford Economics/EFG

Leasing was used by more SMEs than any individual form of bank lending. While 40% of SMEs used leasing, bank loans of over 3 years (the most comparable form of bank finance in duration to leasing), was used by 38% of SMEs.

Beyond the proportion of SMEs using leasing, our survey evidence also allows us to look at the share of SME investment financed by leasing and other sources of funds (known as penetration rates). Our survey shows that SMEs in the 8 countries of our sample financed 16.7% of their total investment in 2010 via leasing. This compares to a leasing penetration rate of 12.9% for businesses of all sizes in the same countries, which means that SMEs use leasing to finance a greater portion of their investment than larger businesses.

The share of investment financed via leasing increases with the size of the SME. In 2010, micro firms financed 10.0% of their total investment though leasing compared to 16.4% for small firms and 17.6% for medium firms.

The share of SME investment financed by leasing is set to increase from 16.7% in 2010 to 18.6% in 2011. By contrast, the share of all forms of bank lending together (i.e. including short & long term loans) was 31.2% in 2010 and is expected to decrease in 2011.



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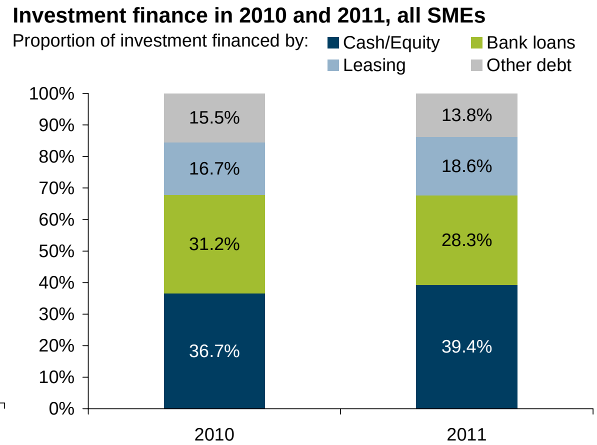


Source : Oxford Economics/EFG

Our estimate of the total value of leasing by SMEs in the 8 countries in our survey is €78bn for 2010. This is made up in roughly equal portions of micro, small and medium sized firms' leasing activity. Scaling this up to the EU level implies that the overall size of the market for leasing to SMEs in Europe is just over €100bn in 2010. As such, SME leasing accounted for 52% of total leasing to businesses in 2010. Combining the 2011 penetration rate with forecasts for SME investment suggests the European SME leasing market will be worth a total of €112.5bn new leasing volumes in 2011.

## What assets do SMEs lease?

SMEs lease an extremely broad range of assets, indicating that the leasing industry is able to finance almost all of the different types of assets SMEs need to run their businesses. Vehicles are the most frequently leased asset type across all countries and economic sectors and, together with machinery and industrial equipment, dominate SME's total equipment leasing expenditure.

Capital intensive industries (such as the manufacturing, mining, utilities and construction sectors) finance larger sums in machinery and industrial equipment via leasing than other sectors whereas SMEs in the service sector spend a greater portion of their leasing expenditure on vehicles and ICT equipment than firms in other sectors.

### Through which channels do SMEs lease?

European SMEs access their leasing through a range of distribution channels and our results show that, in most cases, the typical SME used at least two channels to access leasing in 2010. The vendor channel, where a customer obtains a lease via the manufacturer or dealer of an asset, is the most popular distribution channel. In 2010, 67% of lessees used the vendor channel compared to 58% which accessed leasing through the banking channel, where leases are distributed from a leasing company through a banking branch network, or 36% directly from a leasing company.

### Why do SMEs lease?

As lessors retain ownership of the assets they lease, leasing provides SMEs with the possibility to finance up to 100% of the purchase price of an asset, without having to offer any supplementary guarantees or collateral. Lessees can better manage their working capital by spreading payments over the life of the asset and leasing enables them to use equipment without having to worry about considerations linked to ownership, such as second hand asset values or the disposal of the asset when it is no longer required. Leasing also offers businesses the flexibility to change their leased equipment at the end of the rental period, enabling them to upgrade to the latest and most energy efficient equipment. Additionally, SMEs can opt for leases which cover all of their asset-related needs, for example services such as insurance and maintenance of the asset.

SMEs taking part in our survey were asked why they use leasing above other forms of finance, as well as why they do not use leasing more. All of the reasons identified by respondents for using leasing score highly and there is little variation among the ranking of reasons for why SMEs choose leasing. This indicates that leasing is attractive to SMEs in many different circumstances and provides a range of benefits which meet the needs of diverse businesses. While no single reason stands out particularly, the competitive price of leasing relative to other forms of financing was ranked most important by SMEs. The cash flow management benefits of leasing are also consistently valued across industrial sectors.

For small and medium sized companies in particular, the fact that leasing enables them to finance up to 100% of the price of the asset without posting any additional collateral is also important. This is a major benefit of leasing for SMEs, as leasing frees up capital for other uses.

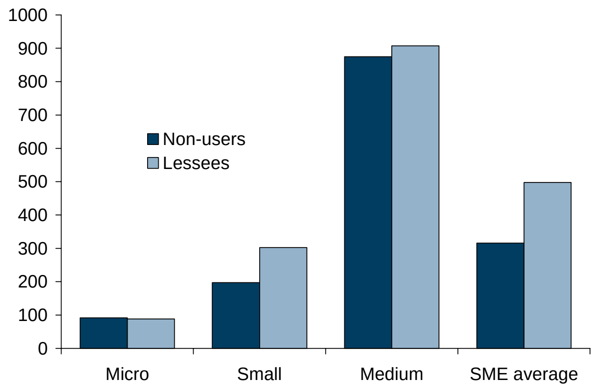
Our survey shows that the reasons SMEs have for leasing diverge more across countries than industrial sectors. In other words, SMEs in the same industry but in different countries appear to have different attitudes towards leasing. This could be because leasing is incentivised to a greater or lesser extent depending on the legal and tax environment of a country.

Lessees and non-users of leasing have similar reasons for not using leasing more. Both groups reported that a principal objection to leasing more was that they preferred to own assets outright.

### Leasing’s role in driving investment and growth

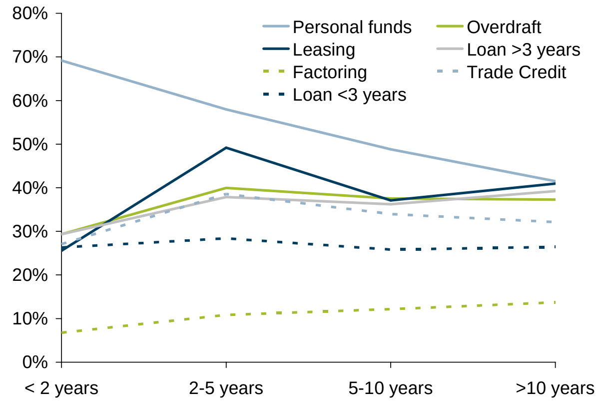
SMEs which use leasing invest more than non-users of leasing. According to our survey, lessees invested an average of €497,000 compared to €316,000 for non-users. In other words, lessees invested 57% more on average than non-users. This general trend holds true across almost all industry sectors. Small lessees in particular may invest more than non-users because they are taking advantage of one of the few external financing options available to firms of that size.

**SME investment spending by firm size**
€thousands, 2010




Source : Oxford Economics/EFG

**SMEs using financing type by age, 2010**




Source : Oxford Economics/EFG

Our survey also shows that leasing is one of the funding sources that new firms are able to turn to most quickly. The take-up of leasing increases from 26% for SMEs less than 2 years old to 50% for SMEs aged between 2 and 5 years, whereas the use of bank loans (of a term over 3 years) increases more gradually, from 29% to 38% for these age groups.

When focusing only on the group of SMEs which used leasing in 2010, our survey shows that leasing accounted for 32.4% of their investment, compared to 30.1% for all forms of bank lending together and 25.1% for cash or equity financing. In other words, leasing is the most important source of investment finance for those SMEs which use it. Raising awareness about the benefits of leasing can improve access to finance for the remaining 60% of SMEs which do not currently use leasing and, by doing so, enable higher investment levels by European SMEs overall.

## SME investment levels and use of leasing in 2011 and beyond

After collapsing in 2009, European investment recovered to a certain extent in 2010. However, uncertainty and financial instability have recently returned and we currently expect firms to slow the pace of recovery in investment spending in 2011 and 2012.

In our report we simulate how a greater uptake of leasing by European SMEs would boost potential economic growth under three scenarios. For each scenario, we calculate the impact on the annual potential growth rate and also the level of potential GDP by 2020 relative to a baseline where the SME leasing penetration rate remains at actual 2010 levels out to 2020.

The scenarios are:

1) Permanently increasing SME leasing penetration from 2010 to 2011 levels
2) Increasing micro firms' leasing penetration to one consistent with that of small firms
3) Increasing SME penetration rates from 2011 levels by an amount equal to the fall that occurred in penetration rates for the whole economy between 2008 and 2010.

Depending on the assumptions, the impact of higher SME leasing penetration on GDP growth ranges from 10 to 15 basis points per annum for the 8 European countries in our sample. Set against the Eurozone's trend growth rate of approximately 2% per annum, this boost is significant and would add an extra 0.9% to 1.5% to the level of GDP by 2020.

A greater uptake of leasing amongst Europe's micro, small and medium sized firms can help generate faster economic growth in Europe by stimulating investment in the productive assets which European SMEs need to enhance their competitiveness.

## Conclusion

SMEs account for 67% of total employment in the EU-27 and accounted for a greater portion of economic growth than large firms over the period 2002-2008 (latest available data). Therefore, it is vital to ensure that SMEs, the motor of the European economy, can finance investment in productive assets. Policymakers around Europe - in Brussels and national capitals – have repeatedly underlined the importance of supporting SMEs as a means of generating economic growth and jobs. This report demonstrates that leasing is a vital source of finance for SMEs. While the focus of government initiatives for SMEs is generally on incentives for start-ups and easing access to bank lending, there is potential for a greater focus on the role of leasing to ensure that European SMEs can invest and expand in the future.

# Glossary of Key Terms and Abbreviations

**Lease**: A lease is a contract which provides a customer (**lessee**) with the right to use an asset for a period of time in exchange for a series of payments[1]. The **lessor** remains the legal owner of the asset throughout the contract. Ownership of the asset may or may not pass to the customer at the end of the contract.

Contracts where legal ownership of the asset passes directly to the customer at the start of the agreement are not considered leases for the purposes of this study.

This definition of a lease covers both finance leases (including hire purchase where appropriate) and operating leases (also known as rental) as defined below.

**Finance Lease**: Although the finance provider (lessor) is always the legal owner of the asset for the duration of the lease, in practice the customer benefits from the asset in a very similar to way to a legal owner. In accounting terminology, the lessee in a finance lease carries the risks and rewards related to the asset.

Situations where this would be considered to be the case include contracts where legal ownership passes automatically at the end of the lease, contracts where the customer has the ability to purchase the asset for a nominal amount or contracts where the length of the lease is close to the useful economic life of the asset.

Across Europe, the term hire purchase covers different types of transactions. In some cases, hire purchase involves the transfer of ownership of the asset at the end of the contract. These types of hire purchase contracts have therefore been included in the scope of our survey (i.e. in the UK, Germany, Poland and the Netherlands) as they meet the definition of a lease. However, in cases where ownership transfers at the beginning of the contract, these types of contracts have been excluded from the scope of the survey.

**Operating Lease**: Leases that are not finance leases are 'operating leases' whereby the customer does not carry substantially all of the risks and rewards related to the asset. Operating leases are commonly referred to as rental contracts in many countries.

Compared to finance leases, operating leases are typically for a shorter duration than the useful economic life of the asset. There is either no possibility to purchase the asset at the end of the lease or, if there is, it is for a higher amount than under a finance lease. Operating leases more frequently include services related to the use of the asset e.g. insurance, maintenance, replacement etc. than finance leases. As such, they enable the lessee to effectively outsource all its asset-related requirements to the lessor.

**SME: "**Small or Medium Sized enterprise". According to the European Commission definition, this term covers any firm with between 1-250 employees, incorporating micro sized firms as well as small and medium.

**Micro firm:** A firm with between 1 and 9 employees

**Small firm:** A firm with between 10 and 49 employees

**Medium firm:** A firm with between 50 and 250 employees

**Penetration rate:** the proportion of a firm's investment that is financed by leasing or another form of finance. This concept is also applied to the proportion of total investment in an industry or country financed by leasing and other forms of finance.

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[1] The definition of a lease used in this report is based on that given in IAS 17, the International Financial Reporting Standard for Leases

**Europe-8**: In this report we use “Europe-8” to denote the eight countries in our sample: France, Germany, Italy, Netherlands, Poland, Spain, Sweden and the UK.

**Leaseurope-27:** We use “Leaseurope-27” to denote the 27 Leaseurope member countries taking part in the Federation’s 2010 Annual Statistical Enquiry. This is broadly equivalent to the 27 member countries of the EU, with the exception of Ireland, Lithuania, Malta and Cyprus, but including Ukraine, Serbia, Norway and Switzerland.

**EU-27**: We use “EU-27” to denote the 27 member states of the European Union.