Risks of long-term leasing transactions for construction industry development

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Abstract. The article examines potential long-term leasing risks for development of the construction industry, characterizes leasing as a form of investment. Leasing objects of the construction industry were identified. Methods for minimizing risks were considered. Leasing companies and large construction companies rarely lease out equipment to private, small-sized construction companies facing general and specific risks. The degree of risk depends on the leasing object (e.g., equipment that cannot be disassembled, rare equipment, expensive equipment which is difficult to sell at an affordable price). The problem to be solved is lack of owned funds for carrying out innovation activities. The article describes funding methods for innovation activities of manufacturing enterprises. It has been found that the most common funding method is leasing. Innovation activities of enterprises are a number of measures aimed to search for, commercialize and implement scientific knowledge, new technology and inventions. Currently, innovation activities influence the Russian economy by enhancing efficiency of resource management, creating new industries, infrastructure and jobs. Under the global competition, the effects of innovation activities on national development and competitiveness are becoming more intensive.

1 Introduction

Leasing is a rent and a financial service. Under the leasing agreement, property is acquired for the needs of a specific tenant.

Leasing transactions have gained the greatest popularity among businesses. They are used in various areas, including the construction industry. In fact, leasing allows a legal or natural person to use equipment without purchasing it. Leasing objects in the construction industry are as follows: special equipment, narrow-profile equipment, computer equipment and software.

According to experts, about 50% of fixed assets of the construction industry is worn out which requires their renewal.

The objects of leasing operations in the construction sector are as follows: industrial equipment, cars, cranes, containers, vessels, etc. For construction companies lacking equipment and machines, leasing operations can be an effective mechanism for upgrading the machinery and equipment. Small enterprises and small contracting construction organizations need various types of equipment for several months – to construct an object. They cannot afford their own repair base, diagnostics and maintenances specialists, etc.

The relevance of this study is due to the fact that leasing transactions generate a large number of risks that can affect the financial development of the lessor and the lessee. The main way to minimize risks is to predict them.
2 Materials and Methods

The article describes characteristics of leasing, identifies potential risks of rental transactions in the construction industry. The way to solve this problem is to predict these risks. The research methods used in the study are analysis and synthesis.

In the construction industry, leasing is used not only for acquisition of vehicles and equipment. It is used when the lessee wants to receive an enterprise which will be further transferred to his/her ownership.

There are different forms of financing of innovation activities:
- leasing involves purchasing of capital assets by enterprises or expensive goods by individuals. It is a long-term rent which contains an option to purchase the leased property at a bargain price and decrease a tax load (Ries, 2011)
- factoring is a financial transaction in which a bank purchases debt recovery rights.
- forfeiting is a financial transaction involving the purchase of receivables from exporters by a forfeiter.

Despite the advantages of leasing transactions as an important financing source, there are some obstacles to leasing development in Russia:
- short loan terms and high loan rates;
- high tax rates;
- if a company purchases equipment at full cost, it lacks sufficient seed capital;
- lack of information about offers of leasing services;
- underdeveloped leasing market infrastructure;
- financial risks of leasing activities;
- macro-economic and political uncertainty in Russia.

Currently, leasing is a promising and flexible economic tool attracting investment funds in real economic sectors, providing support for development of national industries, ensuring reliable long-term income of credit institutes, and providing business support.

The most attractive industries for Russian leasing development are transport (e.g., air transportation), machine building, agriculture, and small business.

To eliminate obstacles to leasing development, the following measures can be taken:
- Market restructuration and reforming to control risks and prevent defaults in the leasing industry.
- Expansion of benefits for long-term financing of leasing deals.
- Insurance.
- Attraction of foreign investment in the leasing industry.
- Development of the leasing market infrastructure (e.g., leasing counselling, qualified staff in the leasing industry).

Currently, new leasing companies appear. They have high positions in the national market.

The current level of innovation development in Russia is lower than the one in developed countries. Decreasing volumes of public funding, the lack of owned funds development strategies cannot be compensated for private investment[4]

3 Results

Leasing companies are ready to solve the problem on a turnkey basis, i.e., to provide workshops, factories or other enterprises with all the required equipment.

This transaction helps the lessee avoid the cost of delivery, customs clearance and equipment installation.
The leasing company may acquire facilities at the construction stage under the purchase and sale contract for further leasing of these facilities. At the same time, the leasing company cannot put an unfinished facility into service because it is not its owner.

Construction companies often conclude leasing agreements. The advantages of leasing transactions for the construction industry are as follows:

- Reduced lump-sum expenses. Advance payment under the leasing agreement ranges from 10 to 20%, and in some cases the acquisition of property can be fully financed by the leasing company.
- Tax benefits. Due to the accounting for lease payment, the company can reduce the income tax. The VAT is reimbursed.
- Flexible payment schemes. The payment schedule can take into account wishes of the client and specifics of the business. For example, it may take into account the seasonal nature of the lessee’s profit.
- Accelerated depreciation. It is possible to reduce tax payment and update outdated equipment and machines.

Along with these advantages, leasing transactions have disadvantages in the financial and credit spheres and cause accounting problems:

1. The leasing agreement is complex due to a larger number of participants.
2. The disadvantages for the lessee are as follows:
   - in case of the financial leasing, lease payments do not stop until the end of the contract, even if scientific and technical progress makes the leased property obsolete;
   - the lessee does not benefit from an increase in the residual value of the equipment;
   - the tax-based return international leasing is often loss-making for the country of the lessor;
   - in case of international multicurrency leasing transactions, there are no full guarantees against currency risks, i.e. problems are transferred from one participant to another.

In addition to the advantages, there are leasing risks. One of the main problems is the need for investment (financial risks).

Force majeure is another risk that can generate significant problems.

The leasing risks are presented in Table 1.

**Table 1. Classification of leasing risks in the construction industry [15]**

| No | Type                        | Description                                                                 |
|----|-----------------------------|-----------------------------------------------------------------------------|
| 1  | Marketing risks            | Impossibility to transfer the equipment to the tenant                       |
| 2  | Accelerated obsolescence   | Since equipment is subject to physical and moral obsolescence, scientific and technical development has to be taken into account |
|    | risks                      |                                                                             |
| 3  | Price risks                | Constantly changing market conditions have a direct impact on the price of the leased asset and potential loss of profit |
| 4  | Decommissioning risks      | This risk can be avoided by performing insuring leased property.            |
| 5  | Unbalanced liquidity risks | Financial losses due to the lessor’s inability to perform obligations       |
| 6  | Default risks              | Inability and impossibility of the lessee to perform obligations under the lease agreement |
| 7  | Interest risks             | Profit deficiency due to changes in interest rates                          |
| 8  | Political risks            | Unregulated and unpredictable public sector policy which affects all activities, including leasing. |

Despite the risks and shortcomings of leasing transactions, leasing is developing and gaining momentum. According to RAEX (“Expert RA”), in 2017, the volume of leasing transactions in the construction and road-building equipment sector increased by 49% and amounted to 76 billion rubles. In 2018, the demand for construction equipment was growing. In the Russian construction and road-
building equipment sector, for the first 6 months of 2018, the volume of leasing transactions increased by 70% and amounted to more than 3 billion rubles.

![Construction equipment leasing](image)

**Figure 1.** The volume of leasing transactions in the Russian construction equipment sector.

An increase in transactions was due to the preferential special equipment leasing program developed by the Ministry of Industry and Trade. A discount of up to 10% of the cost of domestically produced equipment is offered by reducing the advance payment.

The government implemented most of the strategic initiatives for industrial development, renewal of production assets (including construction equipment) through leasing companies and subsidized programs for acquiring fixed assets. The leasing companies act as guides for the government support measures, since subsidies are given to the lessee.

Various discounts from equipment dealers and joint programs of leasing companies and manufacturers make the leasing profitable.

Support programs developed by large automobile producers make it possible to lease construction equipment with zero appreciation, minimum monthly payment or minimum advance payment. Minimum advance payment is in great demand when leasing special equipment. These offers can significantly reduce the burden on corporate clients leasing equipment. Therefore, they are always popular.

In the first half of 2018, leasing construction equipment was used for road construction. On the eve of the World Cup 2018, road and construction companies concluded a lot of leasing agreements in order to repair city roads.

Construction equipment leasing agreements are often concluded by leasing companies, utilities companies, construction material manufacturers, and agricultural companies.

Excavators, backhoe loaders, tractors are in demand.

The lessors usually lease construction equipment. The advance payment is 10% and the contract period is up to 3 years.

According to the forecast, in 2019, the volume of leasing transactions will increase by 25–30%.

Innovation enterprises need significant investment funds. Innovation and investment are interrelated in current manufacturing processes regardless of business scales. Investment in innovation activities aims to introduce new technology in company activities. However, it is necessary to understand that project profitability should be a priority. There are two investment purposes: purchasing of innovation products, licenses, patents; development of innovation products. Unfortunately, the investment structure is homogenous enough and depends on its raw material component. In developed countries, innovation activities are funded by public and private organizations.

### 4 Discussion
Equipment of the real economy sector has a high degree of wear (more than 60%). Depreciation of fixed assets has always been acute. This problem has gained special significance due to international sanctions against Russia. The import substitution policy of the Russian government faced a number of problems: unwillingness of enterprises to increase production, inability to launch production due to technical problems of industrial enterprises. The Russian is experiencing large-scale re-equipment of production and implementation of new technologies [15].

In the construction industry, there are a lot of leasing risks due to the fact that the leasing process is based on the division of labor. Leasing participants are autonomous economic entities with their goals and objectives. This fact makes it difficult to identify risks.

To obtain the maximum result, it is necessary for each participant to have a shared goal; otherwise, a “domino effect” may occur: the collapse of one company entails the bankruptcy of companies associated with the bankrupt one.

The leasing risks are interrelated and have direct positive and negative impacts. They can be distributed between participants in forward and opposite directions. The multidirectional effect of leasing risks makes it difficult to identify and assess their influence on individual participants and entire leasing business.

To prevent risky situations with negative effects, it is necessary to predict these negative situations and take measures to increase the efficiency of the leasing sector of the economy.

Risk classification plays a special role in identifying risks of the leasing company. It is based on causal relationships. Risks of one participant directly or indirectly influence other participants at the micro and macro levels. It is necessary to take into account the multivariate nature of risk assessment and consequences of decision-making at various levels. The classification determines the role of each specific risk which contributes to development of management decisions.

When determining leasing risks, it is necessary to use a step-by-step method, since the risks are distributed in time and space. This type of distribution causes negative cumulative effects.

The step-by-step planning of the multi-step process makes it possible to find an optimal solution and manage risks in the leasing sector taking into account time of their occurrence and coordinates. The solution to this problem is risk management, risk minimization.

5 Conclusion

The main incentive for the use of leasing in the construction industry is improvement of the efficiency of investment. Investments is fixed assets required for economic activities of construction companies. The lesser has a sales channel for leasing, which means that the lesser can perform leasing activities at a faster rate. Leasing transactions are beneficial for the economy. The leasing mechanism is improving.

A special role in identifying risks of a leasing enterprise is assigned to risk classification, which is based on a causal relationship. The risks of one participant generate the risks of another participant who has a direct connection and indirectly the risks of participants who have a direct relationship, and who influence the formation of the result, at the micro and macro levels. It is necessary to take into account the multivariate nature of risk assessment and the consequences of decision-making at various levels. Classification allows you to set the place of each specific risk, which contributes to the development of management decisions.

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Innovation activities are crucial for sustainable development. To this end, it is important to monitor investment in knowledge, technology and ideas contributing to innovation development.

Investment management tools in innovation enterprises should be system-based which requires development of an investment management system. Even under limited investment resources, an efficient investment management system can create possibilities for national innovation sector development.

Under existing economic conditions, mobilization of new development sources and utilization of global innovation opportunities are a priority for all subjects concerned [4].

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