4.1 Introduction

Before trying to develop a lease evaluation model that meets the requirements I-V as discussed in 2.3, I shall recapitulate the models examined in Chapter 3 with the help of these requirements. When developing this new model, I shall start from this recapitulation.

4.2 A Recapitulation

Surveying the various evaluation methods reviewed in Chapter 3 and based on the requirements I-V, the following conclusions may be drawn:

I Formerly in some publications on leasing attention was paid to the financing decision only (e.g. Weston 1962, see p. 40 above), and frequently the investment decision was separated from the financing decision (for instance, by Ferrara, who gives a clear and affirmative answer to the question asked in the title of his 1966 article: "Should Investment and Financing Decisions Be Separated?"). In many recent publications on leasing, however, the very interactions of corporate investment and financing decisions are stressed (e.g., Johnson and Lewellen 1972, as discussed on pp. 83-87 and p. 97 above, and Haley and Schall 1979, see pp. 108-111 above). A very good illustration of these developments may be found in the successive editions of Weston and Brigham's well-known textbook. When discussing the lease-or-borrow problem in earlier
editions of *Managerial Finance*, Weston and Brigham do not mention the capital budgeting decision at all (see for example Weston and Brigham 1966 as analyzed on p. 41) and divorce this decision from the financing decision (e.g., Weston and Brigham 1969, see pp. 43-44). In a more recent edition of their textbook, however, the authors do consider the investment decision and the interactions of investment and financing decisions (e.g., Weston and Brigham 1978, discussed on pp. 77-78). I agree with the latter approach to the problem because the profitability of an investment proposal may depend on the way it is financed. Copeland and Weston very properly argue: "A word of caution to the practitioner is appropriate at this point. It is never advisable to totally ignore revenues or the riskiness of the revenue stream (even though this is frequent practice).... The practitioner who ignores revenues and chooses the project with the lower discounted cost may easily accept a project with negative NPV. Costs tell only half the story. Decision making on the basis of cost comparisons alone is inappropriate unless the decision maker is absolutely sure that the mutually exclusive projects all have positive net present value" (Copeland and Weston 1983, p. 371). Besides, combining the investment and the financing decision may very well be less time consuming than trying to make these decisions separately from one another. What is more, as argued on pp. 8-10, a lot of assumptions have to be met to enable a separation of both decisions to be made.

II With respect to the discount rates to be utilized, there are great differences of opinion among the authors whose models were evaluated in Chapter 3. Among other things the authors disagree as to the rates at which to capitalize the tax savings of leasing and of purchasing. That is why I feel that Bower's sensitivity analysis, by way of which the impact of capitalizing these tax savings at different rates can be measured, is such a useful instrument. Apart from this, in many publications on leasing I have looked in vain for a valid motivation for the discount rates applied. When