

## LEASING ARRANGEMENTS AS A FORM OF FINANCING BUSINESS ENTITIES IN REPUBLIC OF MACEDONIA

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### **Abstract**

*In the modern conditions for working, the problems with providing appropriate sources for financing business entities are more emphasized. In fact, the access to the financing sources is one of the limiting factors for the business entities development. If the business entity is able to satisfy completely or on a higher degree its financing needs from its own sources, then it gains significant competitive advantage and possibility for growth, by decreasing the costs for financing and minimizing the risk. But, these sources most often are not sufficient for business financing. In R. Macedonia, most usually used sources for work financing are the bank loans, which is a result mainly to the non-sufficiently developed financial market, and generally, the low degree of the economic development. However, the bank loans are expensive source of financing, which is negatively reflected into the financial result of the business entities. Because of that, the business entities get down to use alternative financing sources, such as: portfolio investments, foreign direct investments, issue of shares and bonds and specific sources of financing ( factoring financing, forfeiting financing, leasing and financing by franchise).*

*In this paper, the accent will be put on the leasing as a specific form for financing the business entities in R. Macedonia. A research for that how much the business entities are acquainted with the advantages of using this financing source, how much the leasing is present as a financing form and if there are limiting factors in its use, will be conducted. At the end, on the basis of the obtained results from the research, some measures and recommendations for higher leasing implementation in the business entities in Republic of Macedonia will be given.*

**Key words:** leasing, financing sources, financial market

**JEL classifications codes:** G21, G32

### **1. Introduction**

The business entities, no matter how big they are and what their organizational structure is, should provide financial resources for realizing their current and developing work. There are many financing sources available to them. One of the financing possibilities is *leasing*, that is more frequent in the last few years. Besides renting equipment, the leasing also comprises training of the staff that will use that equipment and maintenance and servicing of the rented equipment as well, but also a transfer of modern technology to the leasing user. The leasing, as a form for financing, is offered not only by specialized companies, but by the producers themselves, too, and recently the banks have been

more aggressively offering such type of services to their purchasers. The world developed companies use the leasing arrangements mainly in the area of transportation (especially in the air transportation), then for purchasing modern technology, hardware and software, machines in civil engineering etc. International leasing arrangements are of big importance for the economic development of the emerging countries, because they enable production increase, growth of the competitive ability, unemployment decrease, and keeping the pace with the technical progress. The leasing is a trigger for the small economy development, which is a driving force for economic development of the countries in transition. Namely, this is a source which is very suitable for entities that do not have their own or other sources for financing their work. This context can be illustrated by the thought of the well-known philosopher Aristotle, who says: *“The true wealth is not in the ownership of resources, but in the right to use them”*. So, the business entities, instead to expose themselves on a risk by buying necessary resources, they provide them through the leasing.

## **2. Literature review**

Many organizations are facing a challenging economy beset with currency fluctuations, high commodity prices and intensifying, global, competitive pressures. To meet these challenges, they are looking to fund innovation efforts to grow revenue, restructure operational processes to improve efficiency, and improve financial performance by rooting out any and all unnecessary expense. Given these circumstances, it is understandable that they are seeking and utilizing other ways of acquiring needed resources without using cash reserves or drawing down bank credit lines. Increasingly, both IT organizations and the business units they support are leasing and financing important segments of their infrastructure to achieve additional financial flexibility and improved operational effectiveness. In today's volatile economic climate, many IT organizations, striving to balance the need to invest in new information technology (IT) equipment and software with their organization's goal of minimizing capital spending, are again shifting to leasing and financing their new acquisitions. It is believe that in many situations, technology leasing/financing offers strategic, operational and financial benefits compared with outright ownership (Joseph C.Pucciarelli, 2008).

Leasing is a method of purchasing land equipment or other machinery without having to pay a full amount upfront (Saleha, Yashir Hassan, Shahid Husain, January 2012, Vol.3 No. 9). Financial leasing has emerged as an optimum financing option which provides more room for more procurement since it helps organizations with limited budgets save their capital. Actually all budgets are deemed to be limited, and military budgets are not exceptions. As a matter of fact even the most developed countries with strong economies have been using leasing or financial leasing in defence procurement for many years as well as in their civilian economic activities (Samet Ozkan, Ebry Caymaz, Fahri Enerel, An exploratory research on financial leasing in defence industry: the Turkish case).

While there is no sound disadvantage of financial leasing except for “restricted ownership rights” due to the nature of financial leasing. It has many advantages, some of which are (Leaseurope, 2012; [www.leaseurope.org](http://www.leaseurope.org))

- Finance provision without heavy burdens on sources and capital of the company
- Payment plan along Product Life Cycle (PLC)
- Operational convenience. Lessor deals with the purchase procedures
- Tax and other surcharge exemptions
- Payments can be made by the profits made through the investment itself
- Stable finance management
- Purchase option for a reasonable (fairly low) price at lease end

There many researches about the advantages of the financing with leasing arrangements. A 2008 IDC survey of 153 IT organizations that lease/finance their IT equipment found that more than 70% of them reported the benefits associated with leasing/financing were: aids in protection against obsolescence, a means to balance project cost with benefits, a faster approval process, budget flexibility and equipment disposal/decommissioning services ([www.idc.com](http://www.idc.com)).

## **3. The effects of using leasing arrangements**

The use of the leasing, as a specific form for financing, causes effects that can be viewed from both macroeconomic and microeconomic aspect.

*The effects of the leasing on the macroeconomic plan* are seen through the possibility for additional financing, which leads to increased offer for financial resources and filling the gap on the financial market by providing qualitative, economical and attainable financial resources. The development of the leasing business creates healthy competition in the market for financial services.

Beside this, the leasing gives to each national economy a possibility for using latest high technology, which would otherwise not be attainable because of the high prices. That characteristic of the leasing is especially important for the undeveloped countries, emerging countries and countries in transition, because they have not enough capital, and this fast access to modern equipment (or modern goods), technique and technology is only possible through leasing

financing. This is an opportunity for these countries to increase their production, to support the economic development, to encourage technical-technological progress, and in the course of years, from the leasing users to become leasing providers.

The studies show that the leasing arrangements stimulate the small economy development (small and medium companies), which is especially stressed by the Organization for European Collaboration (OECD) and the European Bank for Reconstruction and Development (EBRD), because they are considered as a driving force for economic growth and development in the countries in transition. In other words, the leasing arrangements contribute to economy modernization, increase of production and equipment sale, improvement of competitive ability, following of the technical progress, decrease of the unemployment rate, increase of the degree of capital investments, and maintenance of national production reputation. Therefore, as higher is the use of the new contemporary resources, the whole economy in each country is better developed, too.

The leasing arrangements are important from the *microeconomic aspect* as well. Namely, the leasing has influence on the future financing of the business entities, mainly depending on the degree of their development. So, mature and profitable entities can use leasing in order to create possibilities for using credit lines which would be intended for meeting other needs. The young, i.e. newly-established companies, through the leasing manage to keep cash and to come to financing sources easier, while various businesses take equipment on leasing in order to avoid technologically obsolete equipment and to keep the ability for upgrading.

#### **4. The leasing in the contemporary world practice**

The leasing, as an economic category, from its beginning up today, has undergone many changes and modifications. The reasons for its increased popularity and expansion in the business world, especially in the countries with developed capital market, should be found in the economic advantages characteristic for leasing transactions, especially when purchasing an expensive electronic equipment, computers, construction mechanization, textile and other modern kinds of machines. The fast leasing development is a result of influence of several factors, among which is the increased necessity of using investing equipment which should be used according to the technical progress. Economic importance of the leasing is especially big with those industrial branches which technology is prone to fast changes. Through leasing arrangements, the companies have possibility to use all scientific and technological advancements, without having to buy them. Additional motivation when using international leasing, are the conditions for leasing offered in the foreign countries (provided they are better than those on the domestic market), tax savings offered by various countries, non-existence of a leasing company in the native country that offers leasing for the required resources etc.

Today, the leasing is a very important price-financial-marketing tool for providing equipment that has the advantages of the same profile both on the domestic and on the foreign markets. For example, only in USA, the leasing arrangements are made by over three thousand specialized leasing companies, i.e. it participates with 1/3 of the total investments in USA. Namely, USA are leader in the international leasing with more than 30% participation in the world market, so in percentages, 35% are on a leasing for transport means, 27% on hardware/software, 15% on civil engineering machines etc.

In Europe, leader in leasing use is Germany, followed by Great Britain, Italy and France. Data from the German Leasing Association (BDL), show that the investments in 2012, in the leasing sector, in Germany, were 49.3 billion EUR with 0,5% growth, compared to 2011. Leaseurope is a federation that unites 46 leasing associations, from entire Europe, and represents about 1300 leasing companies. The range of products comprised by the members of this association is from buying with deferred payment and financial leasing, to operative leasing of all kinds of goods (cars, equipment and real estates). Therefore, it is estimated that Leaseurope represents about 93% of the European leasing market. According to the association Lease Europe, the leasing participation in the total investments in Europe is even 19%.

The following table shows the ranking of European leasing companies by the value of newly-concluded contracts by Leaseurope.

Rank	Company name	Country	Value of newly-concluded contracts within Europe	Number of newly – concluded leasing contracts within Europe
1.	Societe Generale Leasing Solutions	France	12,679,021	350,009
2.	BNP Paribas Leasing Solutions	France	12,338,970	458,496
3.	De Lage Landen International B.V	Holland	9,055,240	281,131
4.	OJSC VEB Leasing	Russia	7,370,590	18,137
5.	Deutsche Leasing	Germany	6,849,000	63,856
6.	UniCredit Leasing	Italy	6,253,517	107,079
7.	Nordea Finance	Sweden	5,212,176	279,421
8.	LeasePlan Corporation N.	Holland	4,590,458	224,815
9.	ING Lease	Holland	4,426,595	57,627
10.	Alphabet International GmbH	Germany	4,375,628	186,717

Table 1. Ranking of the European leasing companies by value of newly-concluded contracts by Leaseurope.

The most characteristic example for international leasing arrangement is airplane leasing. Namely, most of the air companies, instead to buy the planes, they lease them from foreign leasing companies. The world statistics indicates that the leading air companies (United, American, Lufthansa, British, Air France) provide above 40% of their fleet through leasing, while the largest number of airplanes they possess, have been purchased through leasing. The biggest air leasing company in the world, as per the value of its fleet, is International Leasing Finance Corporation (ILFC), which gives planes under leasing to companies such as, for example, American, Continental and Southwest. More precisely, it is a company which portfolio includes over 1000 advanced and ecologically efficient airplanes, supported by a plan for further expansion.

## 5. The leasing in Republic of Macedonia

The positive effects that come out from using leasing arrangements contribute for their higher affirmation in Republic of Macedonia. The leasing importance becomes even bigger having in mind the fact that accumulation realized by business entities is not sufficient for providing the increased needs for renovation and reconstruction of the existing equipment, and the leasing enables them to come to a modern and sophisticated technology, without engaging cash. Its role in Macedonian economy becomes bigger by establishment of the market economy, and so, the leasing is affirmed in the practice of foreign trade, and not only as a form for financing, but also as a way of purchasing equipment and technique. By passing the Law for leasing in 2002, in fact, institutional prerequisites for improvement of this activity were created. The areas of leasing application as a form of financing are limited, and are mainly associated with cars, and less with transport vehicles, trucks, while the equipment and machines, unfortunately, are present in a very low degree.

Although 14 years have passed since creation of legal prerequisites for the leasing, its participation in the financial system is very small and accounts 1,4% of the total assets, and participates with 1,5% in the domestic gross product. In comparison with other countries in the region and Europe, only in Greece the participation in percentages is smaller (0,1%).

As per the structure of the value of the newly-concluded contracts by subject, in 2013, the highest percentage of the leasing contracts refers to light vehicles (mainly cars), and 65.7% are on legal entities. Here, characteristic is low percentage of the financial leasing on real estates that is mainly due to unfavorable tax regulative

which contributes to decreasing of its attractiveness. Especially unfavorable for the Macedonian economy is the low percentage of leasing contracts which subject are machines and equipment (5,8%). In order to increase that percentage, it is necessary Macedonian business entities to have higher economic activity, followed by new investments, expansion of activity, positioning on new markets etc.

Today, in R. Macedonia 9 leasing companies exist, with 5.990 concluded contracts for leasing arrangements. The biggest and most important participants in the leasing offer are LBIS DOOEL (member of NLB group) and EUROLIZING DOOEL. LBIS is the first leasing company founded in R. Macedonia that is specialized exclusively for giving leasing services. This house, at the beginning, worked only with vehicles, but later this form of financing became interesting for buying equipment: trucks, Lorries and buses, then equipment for mills, for production of meat, production of ice cream. Contrary to the first leasing company, EUROLIZING makes exclusively leasing on vehicles, of which 40% loading vehicles and 60% cars. The most frequent users of their services are taxi companies, by which this leasing company assists in the development of some activities.

The practical application of leasing arrangements shows the large number of problems with which the participants in leasing transactions are faced, among which the most important ones are:

- Returning to the leasing grantor's possession in case the contract obligations are not fulfilled by the leasing user.<sup>2</sup> Executive action is long-lasting and not efficient, so many leasing companies complain that they have to be “detectives” in order to find out the leasing debtors, and to make them return the leasing subject (which is a case when physical persons are in question).
- Tax treatment on real estates as a leasing subject. One of the biggest reasons why real estates are very rarely present in leasing transactions is the double taxation with the sales tax on the real estates of 3%. The first taxation occurs at the moment of gaining the possession, while the second taxation is during the possession transfer to the leasing user.
- The leasing is not recognized as a financing with its specifications, by the legislation.
- Accounting problems. In this segment it is necessary to work on elimination of non-compliances referring to accounting aspects with the leasing users and grantors.
- Omissions in supervision and inspection. Transparency in the sector leasing is far from the desired level, so, usually there is a lack of information concerning the leasing activity in R. Macedonia. That is mainly due to the poor supervision by the authorized institutions over the leasing companies.

## **6. Analysis of the results of the conducted poll (questionnaire)**

In order to learn the presence of leasing as a source for financing the business entities in Republic of Macedonia, a research was conducted by the way of questionnaire. Part of the questions are dichotoms (yes-no questions), while part of them are with several offered answers, of which one or more can be chosen. The questions were carefully selected in order to get clearer picture and more quality quantitative analysis of actual conditions concerning the fact how much the managers are familiar with possibilities offered by the leasing. The questionnaire was realized on a representative sample of 60 business entities from the region of Pelagonia. The questionnaire was realized generally through direct contacts or electronic mail, with representatives of the board of directors of those business entities.

From the quantitative analysis good conclusions can be drawn, on which basis very useful recommendations can be given.

On the first question – **Do you know what the leasing is?** – from the polled firms, 67% have answered that they know.

On the second question- **Do you know the effects of using leasing arrangements?** – 62% of the respondents have answered that they do not know the effects of using the leasing arrangements.

On the third question – **Do you use leasing as a form for business financing?** - only 20% have answered positively, i.e. said that they use the leasing in their working.

The fourth question referred to the **subject which is the most usual subject of the leasing arrangements**. 92% of the respondents, purchase vehicles through the leasing arrangements, and only 8% purchase equipment, while none of the respondents purchases real estates through leasing arrangements.

On the fifth question – **Would you like to become acquainted in details with the advantages of using leasing arrangements?** – 75% have answered positively, or three from four business subjects want to become acquainted with the advantages of using the leasing arrangements.

The sixth question referred to the **way on which the business entities would like to be informed about the advantages of using the leasing arrangements**. Most of the respondents, i.e. 78% of them want to be informed about the advantages of using the leasing arrangements through seminars and workshops , while the remaining 22% want to be informed through printed or electronic media.

*Hypothesis I.* More detailed knowledge of the respondents about the advantages of using the leasing arrangements does not depend on the fact if the respondents (entities) know the effects of using the leasing arrangements.

By using CBS-Chi-Square Analysis, at risk of 5% in the statistical conclusion, the following results are obtained:

CBS-Chi-Square Analysis

Information Entered - Observations

Number of Columns:	2
Number of Rows:	2
Alpha Error:	.05
Degrees of Freedom:	1
Critical chi-square:	3.84146

	X1	X2	Total
1 =	23	45	68
2 =	37	15	52
Total	60	60	120

Results - Expectations

	X1	X2	Total
1 =	34	34	68
2 =	26	26	52
Total	60	60	120

Critical chi-square:	3.8415
Computed chi-square:	16.4253
p value:	0

Conclusion: Reject Hypothesis

With the safety threshold of 0,95 and freedom degrees =1, it can be seen that the theoretical value (3,8415) is lower than the estimated value of the chi-square test (16,4253). The same is the conclusion as per p-value ( $0 < 0,05$ ). It means that we refuse the set hypothesis or conclude statistically that the respondents' more detailed knowledge about the advantages of using the leasing arrangements depends on that whether the respondents (entities) know the effects of using the leasing arrangements.

*Hypothesis II.* More detailed knowledge of the respondents (entities) about the advantages of using the leasing arrangements does not depend on that if the respondents (entities) know what the leasing is.

By using CBS-Chi-Square Analysis, at risk of 5% in the statistical conclusion, the following results are obtained:

CBS-Chi-Square Analysis

Information Entered - Observations

Number of Columns:	2
Number of Rows:	2
Alpha Error:	.05
Degrees of Freedom:	1
Critical chi-square:	3.84146

	X1	X2	Total
1 =	40	45	85
2 =	20	15	35
Total	60	60	120

Results - Expectations

	X1	X2	Total
1 =	42.5	42.5	85
2 =	17.5	17.5	35
Total	60	60	120

Critical chi-square:	3.8415
Computed chi-square:	1.0084
p value:	0.2418

Conclusion: Do not Reject Hypothesis

With the safety threshold of 0,95 and freedom degrees=1, it can be seen that the theoretical value (3,8415) is higher than the estimated value of the chi-square test ( 1,0084). The same is the conclusion as per p-value (0,2418>0,05). It means that we accept the set hypothesis or we conclude statistically that the respondents' more detailed knowledge about the advantages of using the leasing arrangements does not depend on that whether the respondents (entities) know what the leasing is.

## 7. Conclusions

The leasing is a relatively new form for financing business entities in R. Macedonia and its presence as a form for financing international business is on a relatively low level. *The promotion and affirmation of the leasing as a form for business financing* is of crucial importance for the business entities to become familiar with its characteristics, advantages and risks. For higher coverage of the leasing arrangements as a new form of financing, it is indispensable to take over the following measures:

- To organize seminars and workshops on which the leasing importance will be emphasized.
- The state should have stimulating policy for promotion and development of the leasing, introduce tax allowances, give state warranties, favorable credit lines etc.
- The Law regulative in the sphere of leasing arrangements should be improved.
- To provide faster executive actions.
- To establish associations and organizations which basic activity and interest will be advancement and promotion of the leasing in Republic of Macedonia.

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