

# **Leasing An Alternative Tool To Financing Algerian Smes In Times Of Crisis**

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## **Abstract**

The fall in the price of hydrocarbons has impacted the functioning of the national economy and growth. Therefore, the main challenge for the national economy is to significantly reduce the high dependence on hydrocarbon revenues and to intensify investment and strengthen domestic production. It is well known that Micro, Small and Medium sized enterprises (SMEs) are the back bone of the economy. Access to financing continues to be one of the most significant challenges for the creation, survival and growth of SMEs. Bank lending is the most common source of external finance for SMEs. Given the current economic slowdown marked by the insidious difficulties of Algerian SMEs in accessing bank financing because of high interest, high collateral requirements and lack of experience with financial intermediaries; leasing as conventional or non-conventional financing seems to be the suitable alternative to traditional bank credit. Leasing with its distinctive features as fairness, stability and efficiency, is a powerful product to provide SMEs with the much needed term-financing to invest in productive and logistic equipment. Despite the advantages offered by leasing, it remains a marginal tool for SMEs financing with a weak penetration rate of 2%. The present paper highlights on “the importance of leasing as an alternative tool financing for Algerian SMEs in times of crisis.” The intention of this paper is to enhance the awareness of leasing, its advantages in conventional and in non-conventional financing versus loans, its significant importance as an alternative means, for Algerian SMEs, that expands access to short and medium term financing for durable goods and equipment.

**Key words:** SMEs. Loans. Leasing. Ijara. Alternative Tool.

## **Résumé:**

La baisse du prix des hydrocarbures a eu un impact sur le fonctionnement de l'économie nationale et la croissance. Par conséquent, le principal défi pour l'économie nationale est de réduire de manière significative la forte dépendance des recettes d'hydrocarbures et d'intensifier les investissements et renforcer la production nationale. Il est bien connu que les PME sont l'épine dorsale de l'économie. L'accès au financement continue d'être l'un des défis les plus importants pour la création, la survie et la croissance des PME. Les prêts bancaires sont la source de financement externe la plus commune pour les PME. Compte tenu du ralentissement économique actuel marqué par les difficultés insidieuses des PME algériennes à l'accès au financement bancaire en raison de l'intérêt, des exigences collatérales élevées et du manque d'expérience avec les intermédiaires financiers ; Le Leasing en tant que financement conventionnel ou non conventionnel semble être l'alternative appropriée au crédit bancaire traditionnel. Avec ses caractéristiques distinctives en termes d'équité, de stabilité et d'efficacité, il est un produit efficace pour fournir aux PME le financement à terme nécessaire pour investir dans des équipements productifs et logistiques. Malgré les avantages offerts par le Leasing, il reste un outil marginal pour le financement des PME avec un faible taux de pénétration de 2%. Le présent article souligne «l'importance du leasing comme outil de financement alternatif pour les PME algériennes en période de crise». L'intention de cet article est de sensibiliser sur le leasing, ses avantages dans le financement conventionnel et non conventionnel par rapport aux prêts, son importance significative en tant que moyen alternatif, pour les PME algériennes, qui élargit l'accès aux financements à court et à moyen terme pour les biens durables et l'équipement

**Mots clés:** PME. Prêts. Leasing. Ijara. Outil Alternatif.

## **Introduction**

The fall in the price of hydrocarbons has impacted the functioning of the national economy and growth. The result is that economic growth and development in Algeria cannot be indefinitely subordinated to the rate of shocks in hydrocarbon prices, which has been the main source of financing driven by the level of public spending. Therefore, the main challenge for the national economy is to significantly reduce the high dependence on hydrocarbon revenues and to intensify investment and strengthen domestic production. It is well known that Micro, Small and Medium sized enterprises (SMEs) are the back bone of the economy. Most of these companies use external financing sources like debt to finance their activities. Bank lending is the most common source of external finance for SMEs, which are often heavily reliant on traditional debt to fulfill their cash flow cycle and investment need. However, traditional bank finance poses challenges to SMEs seeking to improve their capital structure. Yet for most enterprises there are a few alternatives to traditional debt.

Although there is no internationally agreed definition of SMEs, the evidence suggests that these enterprises are more vulnerable in times of crisis. As banks face more rigorous prudential rules, credit restrictions for SMEs will likely persist for the foreseeable future. Moreover, in the area of SMEs access to finance, there are market imperfections, not only in times of crisis but on on-going basis as a fundamental structural issue based on uncertainty and asymmetric information between the demand side (enterprise) and the supply side (financial institution).

Indeed, bank loans are the most widespread debt financing tool for SMEs, but alternative source like leasing have also a high relevance. The present paper highlights on “the importance of leasing as an alternative tool financing for Algerian SMEs in times of crisis.” The intention of this paper is to enhance the awareness of leasing, its advantages in conventional and in non-conventional financing versus loans, its significant importance as an alternative means for Algerian

SMEs that expands access to short and medium term financing for durable goods and equipment. Thus facilitating access to finance is one of the most essential areas for the promotion of SMEs and ultimately for boosting the economic growth and employment creation.

## **I. Literature overview**

### **1. Definition of leasing**

Leasing is a possibility for SMEs to expand their access to short and medium term financing from an economic perspective. Before discussing leasing as a means of financing SMEs, let us discuss leasing itself. Leasing or lease can be defined as “a contract between two parties where one party (the lessor) provides an asset for usage to another party (lessee) for a specified period of time, in return for specific payments”.<sup>(1)</sup> This is also reflected in accounting related definition, according to the relevant international financial reporting standard IAS17 “a lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments, the right to use an asset for an agreed period of time”.<sup>(2)</sup>

Under these definitions, two parties are involved in the lease contract namely:

- Lessor: The party who is the owner of the equipment permitting the use of the same by the other party on payment of a periodical amount;
- Lessee: The party who acquires the right to use equipment for which he pays periodically;

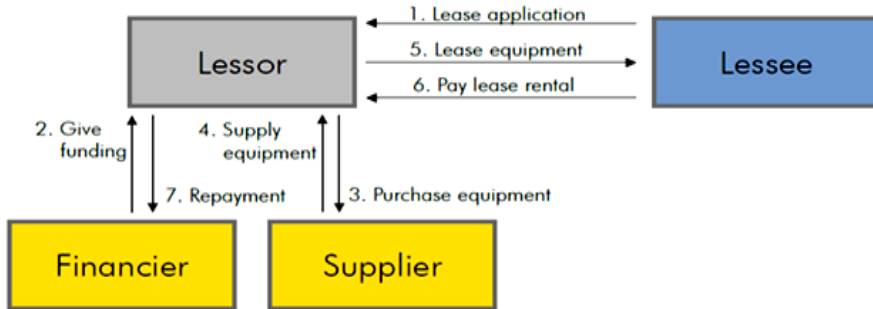
In fact the lease contract is not a sale of the asset, but rather a sale of usufruct (the right to use the asset) for a specified period of time, under it. Also the ownership of the asset rests with the lessor but it is the possession of lessee and right of use is transferred to lessee.

### **2. The leasing mechanisms**

Based on contractual arrangements, the lessee is allowed to use an asset which is owned by the lessor; the lessee pays specified periodic rentals. The lessor relies on the lessee’s ability to generate sufficient

cash flows to pay the lease rentals rather than to rely on the lessee's other asset or track record/ credit history<sup>(3)</sup> (see figure 1).<sup>(4)</sup>

### *The leasing mechanisms*



*Source Based on Izumi (2006)*

### **3. The main types of leasing**

Leases are classified into different types based on the variation in the elements of a lease. There are many different types of lease: sale and lease back, single investor lease and leveraged lease, domestic and international lease, but the two basic types of leasing that we are interested in are finance and operating lease; these are explained below:

3.1 .Finance Lease: is a type of lease also known as capital lease wherein the lessor transfers all the risks<sup>(5)</sup> and rewards<sup>(6)</sup> related to the asset to the lessee. Generally, the ownership is transferred to the lessee at the end of the economic life of the asset. The lessee after paying agreed number of installments is entitled to exercise an option to become the owner of the asset. Here a lessor is only “a financier” or a financial institution that does not render specialized service in connection with the asset.

3.2 .Operating lease: according to IAS 17 the operating lease is one which is not a finance lease<sup>(7)</sup>. Under operating lease, the lessor gives the right to lessee to use the asset or property for a specified period

of time but risks and rewards of ownership are retained by the lessor; normally the lease term is short compared to the useful life of the asset. Here a lessor is not only acting as a financier but he also provides additional services required in using the asset.

#### 4. Advantages of leasing over other conventional financing

The main advantage of leasing over loans lies in a business ability to attain assets without outlaying essential cash in addition to eight main advantages as listed below:<sup>(8)</sup>

**Table 1: Lease advantages versus loans**

Lease advantages	Loans
<b>Absence of collateral requirements:</b> The leased equipment itself is usually all that is needed to secure a loan transaction;	A loan usually requires the borrower to pledge other assets for collateral;
<b>Less documentation involved:</b> A lease can be concluded more quickly and simply; the lessor has to make sure that the lessee has the ability to generate sufficient cash flow through the leased equipment;	A loan requires more documentation and more time in the appraisal. The bank looks into the credit history and asset structure of the client.
<b>100% financing:</b> A lease requires no down payment and finances only the value of the equipment; this enables the lessee to retain more of the scarce resource on working capital;	A loan requires the end user to invest a down payment in the equipment (often up to 40%), the loan finances the remaining amount;
<b>Tax incentives:</b> Both parties	End user may claim a tax

benefit from tax relief on an accelerated basis, overall tax payments on the lease are reduced	deduction for a portion of the loan payment as interest and for depreciation which is tied to depreciation schedule;
<b>Obsolescence:</b> The lessee transfers all the risks of obsolescence to the lessor as that there is no obligation to own equipment at the end of the lease	The end user bears all the risks of equipment devaluation because of new technology;
<b>Lower cost financing:</b> A lease requires only a lease payment at the beginning of the first payment period which is usually much lower than the down payment;	A loan usually requires two expenditures during first payment period; a down payment at the beginning and a loan payment at the end;
<b>Flexibility:</b> A lease does not contain restrictive covenants that limit the lessee's ability to borrow future funds;	A loan agreement usually includes restrictive covenants that require the client to maintain certain financial ratios that may restrict the client ability to borrow future funds;
<b>No risk of fund diversion;</b> The lease funding provided goes directly to the purchaser of equipment without even passing through the hands of the lessee; this averts the risk that the lessee might use the fund for purpose not agreed upon and also avoids the risk that the lessee might use the lease to pay back a loan from	The loan passes through the hands of the end user who might use the fund for purpose not agreed upon;

another financial institution;	
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*Source: Performed by author based on: Leasing for Small and Micro Enterprises.*

## **5. Leasing as non-conventional financing**

### **5.1 Islamic Finance**

The term Islamic finance is used to refer to financing activities conforming to Islamic law (Sharia). The following key principles guide Islamic finance:<sup>(9)</sup>

- ✓ Prohibition of interest or transaction (Riba);
- ✓ Financing must be linked to real assets (materiality);
- ✓ Engagement in immoral or ethically problematic businesses not allowed (as arms manufacturing, or alcohol production);
- ✓ Return must be linked to risks;

With the adoption of stringent Sharia principles, Islamic finance offers a large alternative economic growth opportunity to the conventional methods that many investors have become accustomed. Many countries globally from Europe, Middle East, Asia, Australia and even the United States have realized the importance of Islamic finance. Over the past decade, the Islamic finance has expanded rapidly than conventional finance in Muslim and non- Muslim countries. Islamic finance has emerged as an effective tool for financing development worldwide including non-Muslim countries. It has the potential to help address the challenges of ending extreme poverty and boosting shared prosperity.

### **5.2 Instruments**

Basic instruments include:

- ✓ Cost-plus financing (Murabaha);
- ✓ Profit sharing (Mudaraba);
- ✓ Leasing (Ijara);



- ✓ Partnership (Musharaka);
- ✓ Forward sale ( Bay'salam);

## **5.3 Islamic Leasing**

### **5.3.1 Ijara**

Ijara literally means “to give something or rent. Ijara- financial or operational contract is a contract where the banks purchase asset on behalf of client and allows usage of asset for a fixed rental payment. Ownership of the asset remains with the financier but may gradually transfer to the client who eventually becomes the owner (Ijara wa Iqtina).

### **5.3.2 Economic benefits of Ijara**

We mentioned earlier the advantages of leasing in conventional financing. Let us proceed to discuss the economic benefits of Islamic finance instrument (Ijara). Distinct benefits of Islamic leasing (Ijara) can be named:<sup>(10)</sup>

- As noted above, one of the principles of Islamic leasing or Ijara necessarily involves real assets. This ensures and strengthens the linkage between the financial sector of the economy and the real sector contributing to economic stability;
- Ijara is especially suitable for some sectors of the economy. Since Islamic banks use the mode of financing with the purpose of enabling clients to use durable goods and equipment in productive enterprises who may be unable to buy them for their productive purpose such as SMEs. Ijara has also large potential as financing mode for retail, corporate and the public sectors and can also play a crucial role in promoting Islamic finance industry. It can be used as incentive to economic development as it is usually long term and offers potential for stimulating production in industries.

- Ijara is an attractive mode of investment for Islamic banks because assets acquired under these contracts are usually of high quality marketable value, thus the bank does not have to depend so much on the creditworthiness of the lease and the possibility of minimize of funds on is minimized;
- Furthermore, Ijara offers the advantage of not requiring collateral and thus easier to practice as it involves less documentation and takes less time to conclude a deal;
- Ijara has become popular due to a tax advantages as the rental can be offset against corporate tax by the lessee;
- Finally, Ijara creates a great potential for securitization. Ijara can be used indirectly for sukuk issues by the corporate and government sectors. Securitization on the basis of Ijara is an alternative tool to interest based borrowing provided, it uses durable and usable assets. Furthermore, sukuk based on Ijara can be traded in the market affording a convenient instrument for investing savings to the people of small income who constitute the overwhelming majority in the developing countries in general and in Muslim countries in particular;

## **II. Overview of the state of SMEs in Algeria**

### **1. Definition of SMEs**

Law 17-02 of January 2017 defines small and medium enterprises as enterprises producing goods or services or both by determining certain characteristics as presented in table 2:<sup>(11)</sup>

**Table 2: Definition of SMEs**

<b>Business Size</b>	<b>Employees</b>	<b>Total turnover (MDZ)</b>	<b>Total Balance Sheet (MDZ)</b>
<b>Micro</b>	<b>1 - 9</b>	<b>≤ 40 million</b>	<b>≤ 20 million</b>
<b>Small</b>	<b>10 - 49</b>	<b>≤ 400 million</b>	<b>≤ 200 million</b>
<b>Medium</b>	<b>50 - 250</b>	<b>400 million – 4 Billion</b>	<b>200 million – 1 Billion</b>

*Source: SME Guidance Act*

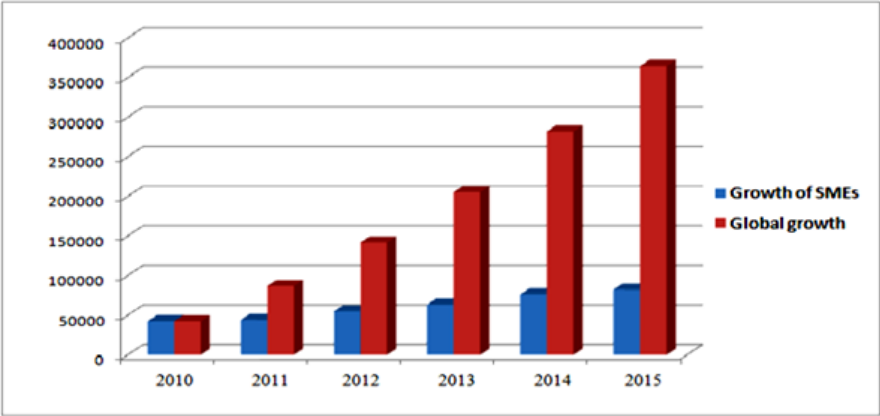
The revision of the SME Guidance Act was initiated by the Ministry of Industry and Mines in 2014,<sup>(12)</sup> with the objective of modernizing the ecosystem of the Algerian enterprise by impelling a new dynamic to the SMEs. Thus, the text introduces an adaptation of the definition of the SME to better correspond to the current context both nationally and internationally. It also extends the scope of the definition of this corporate category to allow access to the following benefits granted by law to SMEs: in creation phase, listed in the stock market, whose share capital is held at the level of 49% by one or more investment companies and which comply with other criterions for the definition of an SME.

## **2. Evolution of Algerian SMEs**

According to the statistics published, by the previous Ministry of Industry, Small and Medium Enterprises and Investment Promotion, and the actual Ministry of Industry, the number of SMEs for the past decade 2001-2009 exhibited an average growth rate of 9%, an average of 25.000 SMEs. During the economic plan period (2005 – 2009) equivalent to almost nearly 100.000 SMEs were created, demonstrating the efforts made by the government to promote the sector. These efforts continued during the economic plan period (2010-2014) as graph 1 illustrates, since the trend of the growth in SMEs creation was in net augmentation, whereas the number of SMEs increased from 619.072 in 2010 to 852.053 by 2014 equivalent to almost 300.000 newly created SMEs, the growth continued in the positive evolution during the first year of the economy plan period (2015-2019) with 1.014.075 SMEs until June 2016. This dynamism shows that SME sector has ensured an increasingly important role in the national economic structure.

**Graph1: Trend of SMEs global growth from (2010-2015)<sup>(13)</sup>**

*Trend of SMEs global growth from (2010 -2015)*



*Source : Performed by author based on data from MIM*

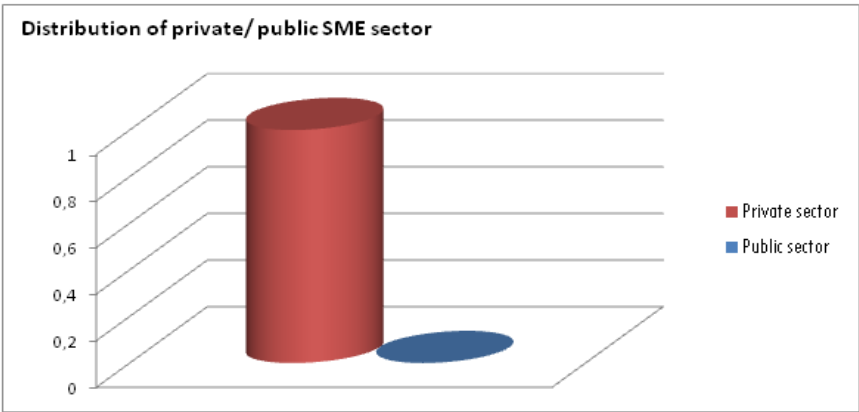
**3. Characteristics of Algerian SMEs**

Algerian SMEs stand out from large companies by the following specificities:

**1- Predominance of private enterprises**

The SME sector is widely dominated by private enterprises since by the end of 2015, 99.94% of global SMEs are private and the remaining 0.06% is public as illustrates

**Figure 2: Distribution of private/ public SME sector**



***Source: Performed by author based on data from MIM***

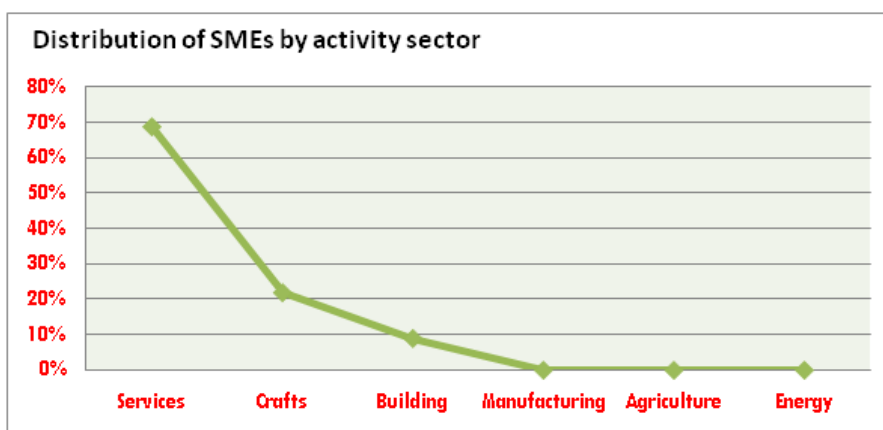
## **2- Predominance of micro-enterprises**

The fabric of Algerian SMES is mainly made up of micro-enterprises with 97% by the end of 2015. Obviously, these previous percentages indicate that SME sector is based on and count on private micro- enterprises to contribute Job and wealth creation.

## **3- Concentration of SMEs in particular sectors**

Algerian SMEs are mainly operating in the service sector (principally transport) and account for 48.86% followed by the crafts sector at 23.25%, and the building sector at 18.05%. The manufacturing sector comprises 5.96% of all SMEs, the agriculture along with energy sector account for only 0.60% and 0.25% respectively of total SMEs by the end of 2015 as illustrates figure 3:

***Figure 3: Distribution of SMEs by activity sector***

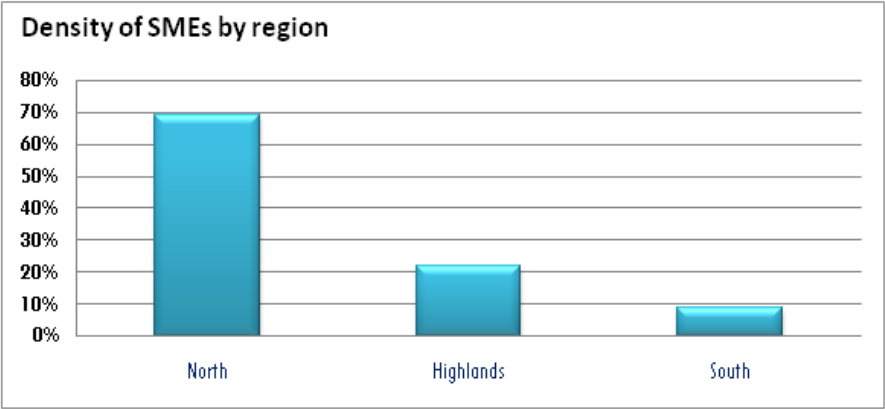


***Source: Performed by author based on data from MIM***

## **4- Predominance of SMEs in the North**

According to the spatial distribution of SMEs in 2015, they are predominant in the North, And to a lesser degree in the Highlands and finally in the South as shown in figure 4:

**Figure 4: Density of SMEs by region**



*Source: MIM 2015*

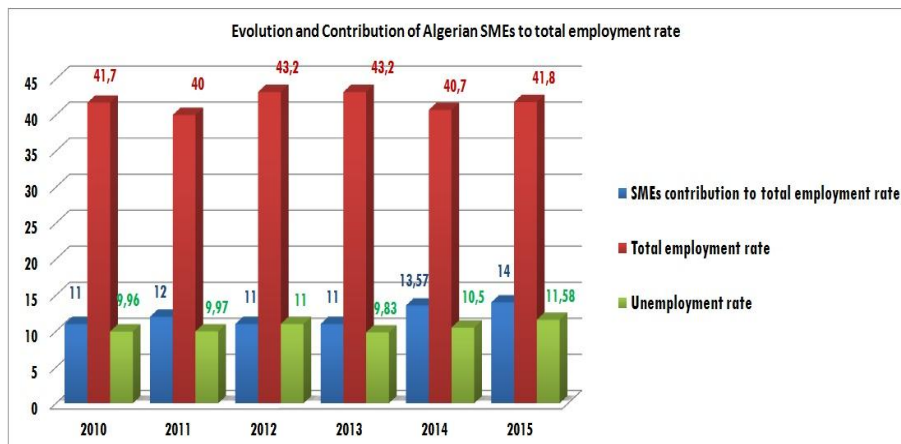
**4. Importance of developing Algerian SME sector in times of crisis**

Small and medium sized enterprises occupy a strategic position in the development process. They represent the vast majority of firms and constitute the crux of the economic fabric in the Mediterranean, North Africa and Middle East region, providing a non- negligible share of jobs and participating in the creation of value added. The dynamism and easily adaptable nature of SMEs contribute to improving competitiveness and supporting the restructuring of the economies. SMEs are considered to be key players in sustainable development as they contribute to all its aspects. Their flexibility and capacity for innovation contribute to the creation of new sources. Governments in the region and in Algeria in particular have been working to build a more conducive business environment and have implemented targeted policy to support SMEs development. The key contributions of Algerian SMEs to the employment and growth are as follows:

- ❖ SMEs play a significant role in all economies and they are the key generators of employment and income and drivers of innovation and growth. Figure 5 below shows the increasing contribution of Algerian SMEs to total employment with a

share that increased during (2010- 2015) from 1.625686 jobs in 2010 to 2.371.020 jobs in 2015.

**Figure 5: Evolution and Contribution of Algerian SMEs to total employment**

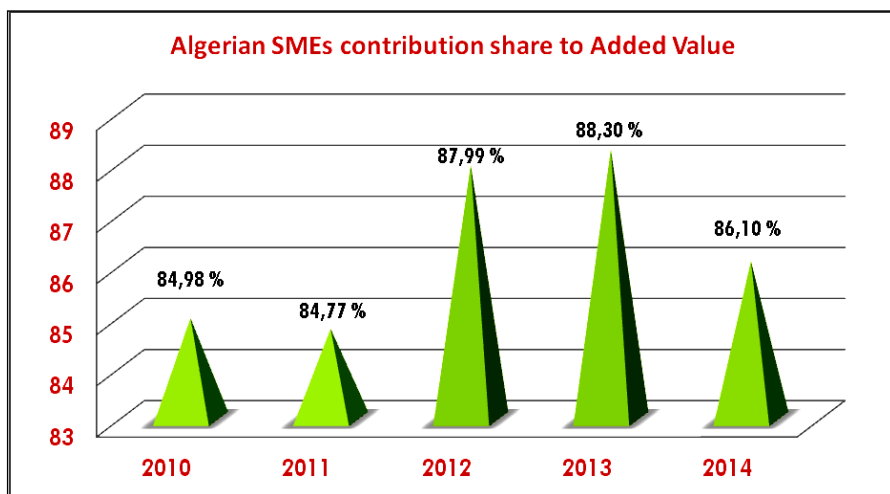


*Source: Performed by author based on MIM, ONS and <http://perspective.usherbrooke.ca/bilan/tend/DZA/fr/SP.POP.TOTL.html>*

But the fact is SMEs contribution rate to total employment is still weak at 14% in 2015. This proportion is far from the proportion of SMEs employment in region's countries.

❖ SMEs participate in the creation of value added. Figure 6 shows that the Algerian's value added (excluding hydrocarbon sector) continues to increase with significant contribution from SMEs with a rate that was 74% in 2000 and increased during the economic plan (2010-2014) to 84.98% in 2010 and arrived to 86.1% in 2014 which is equivalent to a total contribution of 47.338.65 billion dinars. This non-negligible amount highlights the importance of the sector for the economic recovery.

**Figure 6: Algerian SMEs contribution share to Added Value**



*Source: National Statistics Office (ONS)*

However, at the end of 2015, the national economic landscape comprises 934,659 SMEs, 97% of which are micro-enterprises. In terms of SME density, the SME / 1000 inhabitant's indicator is of the order of 23 SMEs, indeed this density is lower than that of international standard with an average density of 45 SMEs/1000 inhabitants.

This finding identifies access to finance as one of the most commonly cited obstacle faced, in particular, by SMEs. SME density is not only correlated with whether or not credit is used but how much. SME density is lower in economies when SMEs have some access to credit but where is not sufficient (underserved). Furthermore, Where SME lending increases, SME density also increases.<sup>(14)</sup> Moreover, on this facet linked to quality, the imbalances take a more pronounced turn:

- ✓ Predominance of very small enterprises, entities by nature vulnerable, expression of a chronic deficit in medium enterprises. This may change with the new law defining SMEs;
- ✓ Territorial location of SMEs marked by a geographic concentration of 69% in the north and 9% in the south.



- ✓ Mortality of SMEs at 10% per year. However, the pace of creation of SMEs remains below the global norm;
- ✓ Algerian SMEs employ only 14% of total labor in which unemployment rate remains high;
- ✓ More than 60% of SME sector activities are concentrated in area with the weakest creation rate such as the services, crafts and building sectors while the sectors neglected have higher job creation rate such as agriculture, tourism and manufacturing;

These situations of imbalance mean that the life cycle of Algerian SMEs faces recurring difficulties and obstacles such as: access to finance, industrial land, and the complexity of certain regulations and procedures that penalize their performance and prevent their Sustainability, the emergence of a dense and competitive industrial fabric.

### **III. Access to external financing for SMEs in times of crisis**

Access to financing continues to be one of the most significant challenges for the creation, survival and growth of SMEs. The problem is being exacerbated by the most severe financial and economic crises in decades. The problem is strongly exacerbated by the financial and economic crises as SMEs have suffered from a drastic drop in demand for goods and services and a tightening in credit terms which are severely affecting their cash flow. The SMEs are generally more vulnerable in times of crisis for many reasons among which are:<sup>(15)</sup>

- ✓ It is more difficult for them to downsize as they are already small;
- ✓ They are individually less diversified in their economic activities;
- ✓ They have a weaker financial structure (i.e. lower capitalization)
- ✓ They have a lower or no credit rating ;

✓ They are heavily dependent on credit and they have fewer financial options;

## **1. Access to external financing for Algerian SMEs in times of crisis**

### **1.1 Algeria economic Overview**

On the economic front, Algeria's fundamentals have steadily worsened since mid- 2014, in line with the slump of global oil prices, in response the government adopted an overdue set of austerity policies in 2017-2018 following some recovery in oil prices; the growth slowdown will continue to be driven by public investment and still significant subsidies. A business climate marked by difficult access to credit, a complex regulatory environment and time-consuming procedures to set up a business, holds back the private sector while the government talks about the need for reforms, the steps it has taken have been modest. Indeed, economic diversification and reduced reliance on the hydrocarbon sector are both key to strong and balanced growth.<sup>(16)</sup>

### **1.2 Access to bank credit for Algerian SMEs**

Even though, external financing SMEs plays a key role in building a competitive private sector and contributing significantly to employment, compared to large enterprises, SMEs often face obstacles in securing access to external financing sources. In Algeria, SMEs, in particular, are constrained by financing gaps such as high interest, high collateral requirements and lack of experience with financial intermediaries. The Algerian banking system is large but is dominated by state-owned institutions; In fact, economic indicators demonstrate that Algerian banks, with a more stable and political environment, recorded an expansion of credit activities during the period 2003- 2014, since the ratio of domestic credit to the private sector (% GDP) ranged to 18.4% in 2014.<sup>(17)</sup> But far insignificant compared to other countries in the MENA region were the share of credit to the private sector increased in Tunisia and Lebanon by 92% between 2008- 2014.<sup>(18)</sup> Moreover, SME financing in Algeria is dominated by banks, with capital market and non-financial institutions

being insignificant financing scores; studies demonstrate that bank lending to SMEs is low, only 16.4% of Algerian SMEs have access to loans and the average share of SME investment financial by bank loans is only 7.15% which is the lowest rate among SMEs in other MENA, OECD countries and the world average.<sup>(19)</sup>

Although, Algeria banks may be less risk averse because they have the highest rates of credit concentration, access to financing remains highly unfavorable for SMEs because of the high interest rate and high collateral requirements. Yet the cost of inaction is very high: lack of access to adequate and timely finance affects the creation of new enterprises and the growth of existing ones.

Nevertheless, facilitating access to finance is one of the most essential area for the promotion of SMEs and ultimately for enhancing economic growth and employment growth creation. The provision of external finance enables enterprises to meet working capital requirements, fill temporary gaps in the cash flow cycle and support extension plans, leveraging the enterprises' internal resources.

#### **IV. Leasing as alternative source of financing Algerian SMEs in times of crisis**

In period of economic slowdown, as SMEs experience internal resource constraints and need to rely on external sources of finance while bank tend to decrease lending , furthermore, access to bank credit remains limited in Algeria, leasing can provide an alternative financing solution for SMEs.

##### **1. Measures to support the financing of SMEs through leasing**

Given the current economic situation marked by the insidious difficulties of SMEs in accessing bank financing, leasing should be an alternative to traditional bank credit. Introduced as a simple credit operation, under the Money and Credit Act of 1990 leasing is now defined as a form of financing that facilitates the acquisition of property and equipment necessary for the development of enterprises. In order to promote this new form of financing and encourage its use, many tax measures have been taken by the public authorities and introduced in the various finance acts from 1996 to 2012:

- ✓ Deductibility of the taxable profit of the rent To the lessor;
- ✓ Exclusion from the scope of the tax on the professional activity(TAP) of the amount of rents received corresponding to the depreciation of financial lease operations;
- ✓ Exemption from VAT of acquisition operations carried out by banks in the context of leasing;
- ✓ Exemption from registration fees for equipment or professional buildings retroceded by the lessor in favor of the lessee at the time of the exercise of the buy option by the lessee in respect of this retrocession;
- ✓ Banks and leasing companies are allowed to align the tax depreciation of assets acquired under leases against the financial amortization of credit;

## **2. Leasing market in Algeria**

The advantages offered by leasing financing in Algeria have led to a remarkable evolution characterized both by the gradual entry of new leasing companies in recent years due to the willingness of the public authorities allowing the creation of SMEs and a significant increase in the use of Algerian SMEs and professionals this financing tool. Leasing is in the process of becoming the preferred mode of financing for SMEs. The leasing offer in Algeria is provided by 12 companies divided into two distinct groups:

On the one hand, financial institutions specialized in leasing:

- Financial institutions whose leasing is the sole activity:
  - National Leasing Corporation (SNL) - (BNA-BDL);
  - Arab Leasing Corporation (ALC):
  - Maghreb Leasing Algeria (MLA):
  - El Djazair Ijar (CPA- BADR- ASICOM)
  - Ijar Leasing Algeria (ILA) – (BEA – BANCO ESPIRITO SANTO);

And on the other hand, banks or financial institutions with a leasing department:

- Financial institutions whose leasing is not the only activity:
  - Financial investment company (SOFINANCE);
  - Mortgage refinancing company (SRH)
- Commercial banks that offer leasing as a banking product:
  - Al Baraka Bank;
  - BNP Paribas Algeria;
  - Société Générale Algeria;
  - The Housing Bank For Trade and Finance;
  - Essalam Bank (El Ijara For the leasing activity);

The demand for leasing in Algeria has been boosted in recent years by two fundamental phenomena which still exist and which militate in favor of an increasingly greater development of this market for the next few years:

- ✓ The development of the SME sector and the willingness of the Algerian authorities to set up a diversified and productive economy sustained.
- ✓ The willingness of the Algerian authorities to modernize and diversify sources of finance for SMEs through the use of leasing as a preferred means of financing by SMEs fabric;

### **3. Leasing market constraints in Algeria**

Despite the advantages offered by leasing, the leasing market remains an embryonic one in comparison with the MENA countries. Whereas in neighboring countries the level of leasing financing ranges between 7% and 10%, the penetration of leasing into investment financing does not exceed 2%. According to experts, a financial innovation takes time to spread. Various reasons explain the inconclusive results of the introduction of leasing in national financial culture:

➤ The culture of bank credit is still dominant. Most Algerian companies, especially SMEs, are unable to discern the long-term advantages of leasing on the one hand and companies prefer ownership to renting on the other;

➤ The rate applied is dissuasive. When a new financial product is introduced, the rental base rates must be reasonably up to 5% in Algeria. But in case of leasing companies it is obvious that the cost of leasing is high since they must purchase the equipment in advance and therefore this investment affects their overall cash because they do not have savings collection unlike banks;

➤ The lack of vulgarization. The practice did not spread quickly because of Cultural inertia;

➤ Lack of information and communication;

➤ Banks impose a multitude of conditions on leasing seekers: a personal contribution varying from 9% to 30%, having an account at their level, and having an experience of more than 2 years;

➤ Reliability of the technical-economic study of the project in the sense that the lessor can only commit if and only the project can generate sufficient resources to meet the rent deadlines;

➤ The supply is below the potential demand for leasing due to weak competition and the reduced number of lessor offering standard leasing products;

➤ Lack of competition is an obstacle to increasing market share leasing; Indeed, what makes companies, banks and financial institutions operate in this case the stock exchange, capital, the bond market, that are not developed in Algeria;

The economic actors and the experts do not despair and still remain optimistic about the future of the leasing market in Algeria. One of the key factors on which the willingness to develop this market will be based is the prospect of creating 2 million SMEs by 2025. So the offer

could be multiplied by 10 to 15 in the next few years, this will allow the market leasing to exceed \$ 5 billion.

## **V. Model of leasing activity in a financial institution and in a private bank in Algeria**

### **1. National Leasing Company**

#### **1.1 Overview**

The National Leasing Company is a public enterprise established in the legal form of a stock company. The purpose of the company is to finance leasing transactions in movable assets for industrial and professional use. The company currently has 11 open sales areas at the branches of the national bank of Algeria and the development bank. The company's activities actually began in April 2011.<sup>(20)</sup>

#### **1.2 Leasing market share of the company**

According to information collected, the leasing market is estimated by the company to 56 billion dinars in 2015, against 51 billion dinars in 2014, 32 billion in 2015 and 26 billion dinars in 2012. These figures give an idea of the volume to be realized in the coming years and the possible margin of progression. Indeed, the penetration rate of leasing in 2014 is 3.3% in relation to gross fixed capital formation, while the standards of the leasing industry suggest that it can reach 10% or 15% as is the case in countries with similar economies. Given the ever increasing financing needs of SMEs and the number of companies that lease in Algeria, the penetration rate will approach 7% of gross fixed capital formation.

Taking into account the foregoing and the prospects for the development of the Algerian leasing market, the overall market share of the National Leasing Company is described as follows:

**Table 3: Overall market share of the National Leasing Company (Unit in thousands of dinars)**

<b>Year</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>
<b>Market</b>	<b>56.100.000</b>	<b>61.710.000</b>	<b>67.881.000</b>	<b>74.669.100</b>	<b>82.136.010</b>	<b>90.349.611</b>
<b>Market evolution</b>	<b>10%</b>	<b>10%</b>	<b>10%</b>	<b>10%</b>	<b>10%</b>	<b>10%</b>
<b>NLC Leasing production</b>	<b>4.326.292</b>	<b>5.407.865</b>	<b>6.489.438</b>	<b>7571.012</b>	<b>8.652.586</b>	<b>9.734.158</b>
<b>Leasing production evolution</b>	<b>38%</b>	<b>25%</b>	<b>20%</b>	<b>17%</b>	<b>14%</b>	<b>12%</b>
<b>NLC market share forecast</b>	<b>8%</b>	<b>9%</b>	<b>10%</b>	<b>10%</b>	<b>11%</b>	<b>11%</b>

**Source: National Leasing Company**

## **2. Société Générale Algeria**

### **2.1 Overview**

Société Générale Algeria, wholly owned by the Société Générale group, is one of the first private banks to settle in Algeria since 2000. It has 87 branches, including 11 business centers dedicated to corporate customers. It offers a diversified and innovative range of banking services to more than 370,000 individual, professional and corporate clients.

Société Générale Algeria realized in 2015 a turnover of 15148 billion dinars up 14% and a net profit of 4.4 billion dinars, with an estimated 32% growth last year compared to 2014. This trend is particularly marked in 2015 in the SME credit segment, which



registered more than 50%. Corporate clients constitute 97% of the bank's credits, of which 56% are large companies and 31% are SMEs. Individual and professional customers account for 13% of the bank's credits.<sup>(21)</sup>

2.2 Leasing market share of the bank

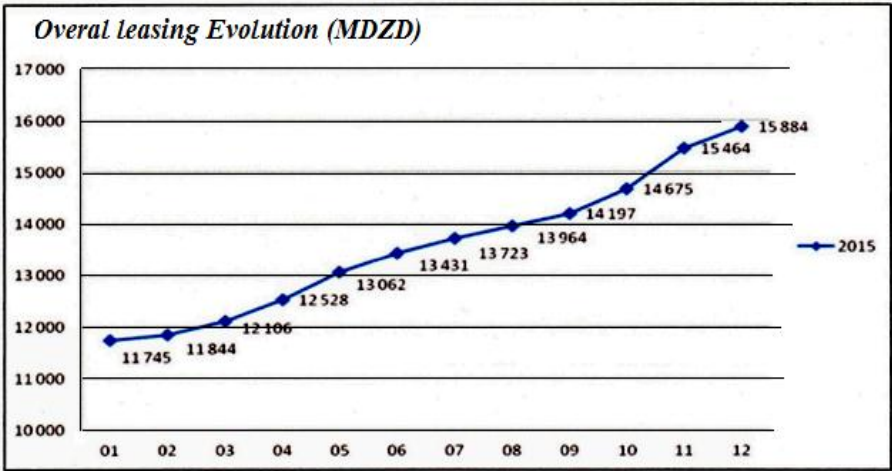
In 2015, the leasing business has experienced significant growth of 103% compared to 2014 and the overall leasing totaled 15,886 (MDZD) as illustrate table 4 and figure 7 respectively:<sup>(22)</sup>

**Table 4: All market leasing production evolution**

Year	2014	2015	%
leasing production	4767	9669	103%

*Source: SGA*

**Figure 7: Overall leasing evolution (MDZD)**



*Source: SGA*

In terms of leasing production, it is important to note that this growth is supported by the performance of the professional market which achieved an evolution of 188% compared to 2014 and a growth rate of 88% as illustrates table 5:

**Table 5: Leasing production evolution, professional market**

Year	2014	2015	%	%
leasing production	2595	4885	188%	88%

*Source: SGA*

Leasing market represents today 49.48% share of the annual production of the bank. Société Générale Algeria is positioned as a major player in the Algerian leasing market with a market share of 22%.

### **Conclusion**

It is well known that SMEs are the backbone of the Algerian economy with 300.000 newly created SMEs. This dynamism shows that SME sector has ensured an increasingly important role in the national economy. The development of non-oil private sector is still one of the Algerian government's priorities. Previous assessments indicate that Algeria has made significant progress in its SME support policies. Indeed strong SME sector can bolster the Algerian economy by broadening and diversifying the domestic economy.

However, findings identify access to finance as one of the most commonly obstacle faced by Algerian SMEs. Given the current economic slowdown marked by the insidious difficulties of SMEs in accessing bank financing, leasing as conventional or non-conventional financing seems to be the suitable alternative to traditional bank credit. Leasing with its distinctive features as fairness, stability and efficiency, is a powerful product to provide SMEs with the much needed term-financing to invest in productive and logistic equipment and particularly effective in emerging economies as Algeria where SMEs provide strong growth and employment opportunities. In order to promote this new form of financing, Algerian authorities established many incentives for SMES and leasing institutions including tax and value added exemptions since 1996. Some improvements were witnessed in leasing activities, although a legal framework has been in place since 1996, it is only recently that this

activity has started to emerge and despite the advantages of leasing, it remains a marginal tool for SMEs financing. In fact, the penetration rate of leasing activities has reached 2% only comparatively weak rate with respect to neighboring countries such as Tunisia 8% and Morocco 6%. Nevertheless, the number of lease increased from 1 to almost 12 in 2014 which aim to position itself well in the leasing market with a growth of shares like the bank “Société Générale Algeria” and the financial institution “National Leasing Company”. As a result of these study findings, recommendations are as follows:

- ✓ To continue the progress made in the SME support policies, Algeria should solve its problems of policy coordination and efficiency, before further extending the scope of its policy instruments and allocating additional resources to the promotion of entrepreneurship and the development of SMEs;

- ✓ Government policies must encourage policies that favor lease finance to SMEs amid increased aversion to risk, especially in a period of slowdown as SMEs experience internal resource constraints and need to rely on external source of finance while banks tend to decrease lending;

- ✓ Developing a dynamic leasing sector can greatly benefit the Algerian economy as it creates access to finance for SMEs, which in turn can create employment opportunities for domestic investment. Also by developing additional financing tool as leasing, Algeria can deepen the activities of its financial sector by introducing new products;

- ✓ Algerian government has to implement a comprehensive legal framework to fully develop sustainable leasing activities because leasing laws are already approved but it is difficult to evaluate whether these laws are well implemented and in line with international good practice;

- ✓ Improving the business climate to boost investment, including leasing;

✓ Tax incentives for leasing and SME investment deserve more attention;

✓ Algerian government faces a huge problem of informal sector, so leasing as a means of financing plays a critical role in bringing in small businesses into formal financial system. Once informal businesses have access to lease financing, they begin building a history of financial transactions. When the appropriate credit information-sharing infrastructure is in place, banks and other financial institutions can access these records, better manage risk and start providing widespread financial services to these small businesses. With this new opportunity, small businesses also find additional incentives to join the formal sector;

✓ The need to form a data bank within financial organizations is proving to be of the most urgent decision-making intensity. Thus, the current non-disclosure of the figures by the banks would see its problematic satisfied;

✓ In view of the low literacy rates, another priority would be to develop an action plan that would aim to educate entrepreneurs about existing financial products and their use.

✓ A campaign to popularize this indispensable instrument is more than necessary for the development of the SME sector.

Restoring the SME's place in the national economy as it is by strengthened and permanent SMEs that Algeria is entitled to increasingly high levels of growth.

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