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# LEASING: A POTENTIAL SOLUTION FOR SME EXPANSION AND RURAL FINANCIAL SECTOR DEEPENING: A STUDY OF RUSSIA

microREPORT #46



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This publication was produced for review by the United States Agency for International Development. It was prepared by Sherry Sposeep (Chemonics International) with Irina Sedova (Chemonics International).



# LEASING: A POTENTIAL SOLUTION FOR SME EXPANSION AND RURAL FINANCIAL SECTOR DEEPENING: A STUDY OF RUSSIA

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# ABBREVIATIONS AND ACRONYMS

AFC	Agro-industrial Finance Company
BDS	Business Development Services
CALP	Central Asia Leasing Project
DCA	Development Credit Authority
EBRD	European Bank for Reconstruction and Development
FMO	International and Netherlands Development Finance Company
GDP	Gross Domestic Product
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit (Germany)
IFRS	International Financial Reporting Standards
IFC	International Finance Corporation
MFI	Microfinance Institution
MIS	Management Information Systems
OPIC	Overseas Private Investment Corporation
RAF	Rural and Agricultural Finance
RLDG	Russia Leasing Development Group
SME	Small and Medium Enterprise
SOW	Scope of Work
TACIS	Technical Aid to the Commonwealth of Independent States European
VAT	Value-Added Tax
USAID	United States Agency for International Development
USD	United States Dollar

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# EXECUTIVE SUMMARY

***Definition of Leasing:*** In Russia, the term “leasing” refers to financial leasing, in which the lease term is set close to the expected economic life of the equipment and lease payments are set so that their total over the lease term covers the cost of the asset plus interest and profit. At the end of the lease term, the lessee usually has the right to purchase the equipment for a nominal fee.

## INTRODUCTION

This paper explores how the development of leasing markets can effectively expand access to medium and long-term financing for rural small and medium enterprises (SMEs) and agribusinesses.<sup>1</sup> Drawing upon recent field work in Russia, this paper investigates the experiences of leasing companies that received technical assistance and/or investment from International Finance Corporation (IFC). How have legal, regulatory, and policy issues been addressed to create a more equal playing field for leasing industry development? How does access to finance inhibit the growth and expansion of rural and agricultural SMEs in Russia? What are the main challenges facing leasing companies serving SMEs and how are they overcome? Are leasing industry development interventions in Russia replicable in other developing countries?

Throughout Eastern Europe and Central Asia, rural and agricultural SMEs face the constraint of replacing old machinery or obsolete equipment in addition to the challenges associated with the seasonality of agriculture. In Russia, about 75 percent of fixed assets are obsolete, generating a high demand for capital asset replacement among SMEs. After the 1998 economic crisis, many large enterprises were broken apart and divided into SMEs. Many of these enterprises are now crippled by old productive assets, which stifle enterprise growth and expansion.

Seasonal, credit and property risks create additional difficulties for agricultural SMEs to access finance. Twenty-seven percent of Russia’s population lives in rural areas where agricultural SMEs are an important source of employment and two-thirds of the country’s rural population

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<sup>1</sup> In this paper, medium and long-term financing refers to a period of approximately three to five years. While longer-term financing (ten years plus) is common for the leasing of real estate in some countries, the typical lease term offered by the companies examined in this field research was three years.

***Leasing: An Alternative  
Financing Tool for RAF***

Leasing provides many advantages to rural and agricultural SMEs that do not have a lengthy credit history or a significant asset base to purchase equipment or collateral to secure a loan. In a leasing program, leasing companies evaluate a potential lease based on the lessee's ability to expand the business from revenues generated through use of the asset. This contrasts to traditional bank lending which evaluates a client based on prior credit history and financial statements.

generates their income from agricultural activities. However, agricultural SMEs are vulnerable to idiosyncratic, weather-related risks and this constrains their access to finance. In addition, weak regulation and enforcement of the land code discourages creditors from accepting land as collateral, inhibiting the ability of agribusinesses to take out bank loans.

While some SMEs are able to obtain working capital bank loans, many struggle with inadequate access to the medium or long-term financing to invest in newer, better technologies and improved equipment as well as to finance agricultural production. This lack of medium and long-term financing prevents them from undertaking investments that could enhance the scale or productivity of their operations.

### **RUSSIA'S LEASING INDUSTRY**

In this challenging environment, the development of leasing markets in Russia holds much potential to increase the growth and competitiveness of the SME and agriculture sector. The development of leasing as a complementary tool to bank loans provides an alternative solution for financing major capital investments such as equipment and significantly expands the available pool of medium and long-term capital to SMEs. Since successful donor interventions in the late 1990s, leasing markets in Russia have demonstrated success in terms of developing enabling environments conducive to leasing and leasing innovations that specifically target and expand outreach to SMEs. However, the inability to access debt and equity finance to capitalize leasing portfolios and fund new deals has constrained some leasing companies, and the lack of available debt financing by Russian banks has prompted some to explore foreign finance options.

The leasing industry in Russia is characterized by different types of lessors, both private and government-owned. Russian banks created many leasing companies at the onset of industry development, but these companies have since expanded their client base and financing sources and some have become independent leasing companies. Foreign banks also set up some leasing companies, although they will unlikely dominate the future market since they will want to contain Russian country risk exposure. Large, financial industrial groups played a role in establishing leasing companies, specifically to supply equipment to companies within the group. As the leasing industry develops and can adequately serve the needs of this market segment, it won't make operational sense for financial industrial groups to continue engaging in leasing activities, and this service can be outsourced for greater efficiency.

In the private sector, captive leasing companies or supplier-owned leasing companies, both Russian and foreign, are becoming more common. Foreign equipment suppliers, such as Caterpillar, John Deere, and Klauss, will likely play an increasing role in the Russian market. The captive leasing company model is effective in that the manufacturer and dealer network have a specialized knowledge of the client base, which permits stronger risk analysis. The suppliers are often geographically positioned closer to the lessees than in other leasing models. Leasing companies established by private individuals



do not constitute a large share of the current leasing landscape, but are key regional players that meet the financial services needs of underserved pockets of SMEs. There are also government-owned leasing companies, operating on either a commercial or non-commercial basis. The government-owned Rosagroleasing dominates the agricultural leasing sector and distorts market forces through subsidized, below market interest rates.

Secondary markets for leased equipment are scarce except for movable assets, such as cars, tractors and combines. The underdeveloped secondary market for equipment poses a challenge to mitigating risks for leasing companies. However, arrears and write-offs have generally been smaller in Russia's leasing industry than those of traditional lenders for several reasons. Leasing companies hold title to the equipment during the lease period and productive equipment is too important to client operations to risk losing it by defaulting on lease payments. Leasing companies further employ a range of risk-mitigation techniques and policies to limit risk exposure and protect against default. These practices include portfolio diversification, tailored repayment schedules, rigorous risk analysis, buy-back and remarketing agreements, and insurance. Higher than usual down payments for leases are common in Russia, putting additional pressure on the client to repay. Leasing services can be viable and profitable if risks are well-analyzed and deals are properly.

Today the policy, legal and regulatory framework for leasing is relatively developed and leasing companies rarely cite legal and regulatory issues as a major hindrance to operations. This is due to the efforts of multiple stakeholders, including the private sector, government, and donors in advocating for a transparent enabling environment to ensure the industry's long-term stability and growth. IFC's Russia Leasing Development Group project in coordination with other key leasing stakeholders drafted amendments and framework agreements to resolve both internal contradictory provisions and contradictions that existed among the various legal acts. When the 2002 Federal Law "On Amendments and Addenda to the Federal Law on Leasing," passed, it substantially reduced the investment risks created from legal and tax uncertainties and established a stronger legislative base for the leasing industry to develop. In Russia, the main tax advantages to leasing are the flexibility to record an asset on either the balance sheet of the lessor or lessee, accelerated depreciation of the asset up to a factor of 3, lowering profit and property taxes, and the ability of lessees to fully expense leasing payments, lowering the taxable profit.

## **LESSONS LEARNED AND RECOMMENDATIONS**

Overall, leasing has significant potential as a tool to expand medium and long-term finance to SMEs and deepen the rural financial sector; and a solid policy, legislative and regulatory framework coupled with donor initiatives on both the investment and technical assistance side can nurture and stimulate this industry formation. Based upon a literature review of IFC-facilitated leasing interventions and field work in Russia, the following donor recommendations can be made, which

cover the areas of enabling environment, technical assistance, and investment, and are replicable to other developing countries.

***Encourage an appropriate legal and regulatory environment, conducive for potential leasing players to enter and exit the leasing market.*** A licensing regime is a bureaucratic barrier that may actually prevent or delay the entry of leasing companies rather than protect the market from corrupt or weak companies from entering. A level playing field for leasing companies to profitably operate and compete fairly is necessary particularly with regards to receiving the same Value-Added Tax (VAT) and customs duty treatment as provided to other financial institutions. Sound, transparent, and consistent legislation on leasing can reduce investment risks and uncertainties that impede leasing industry development.

***Support a clear tax policy that has advantages to the leasing industry to provoke the demand and supply side of the leasing market.*** While the leasing industry in some developed countries has expanded without the presence of advantageous tax treatment on leasing, beneficial tax treatment is often needed to spur industry growth. Identify and coordinate closely with a policy champion to push through a policy reform agenda. A policy champion can contribute political insight and an effective approach to tackling institutional change. Champion(s) who are responsive and open to working with key stakeholders are also crucial to generating a participatory process that includes opportunities for discussing, drafting, and finalizing policy reform. Once tax policy is reformed, engage local governments especially tax authorities to explain how leasing operates and the benefits it can have on the local economy to lessen the scrutiny regarding leasing activities and create a more transparent environment.

***Socially responsible investors and financial institutions demonstrate the viability of leasing as a financing option by investing in leasing companies that develop the industry.*** In Russia, IFC has been instrumental in developing and promoting the leasing industry through equity and debt investment. IFC provided equity financing of \$3 million to establish AFC to enhance leasing to the agricultural sector. AFC has two other shareholders-Rabobank and Netherlands Development Finance Company (FMO). AFC has \$1.5 million in equity shared among three shareholders and \$15 million in loan capital, from its three shareholders, in which IFC assumes the syndicated risk.

***Market-oriented guarantees, such as USAID's Development Credit Authority (DCA), can be used in conjunction with technical assistance to generate greater access to finance among leasing companies.*** "Money is the raw material of the finance industry," as one leasing company president in Russia said. A guarantee facility could support a commercial bank's extension of long-term loans to viable leasing company partners. USAID missions can consider use of DCA to leverage domestic long-term bank financing to leasing companies to achieve strategic objectives, such as expanded services to

rural areas, SMEs and agribusinesses. In the case of Russia, preparation for a DCA loan guarantee could begin in 2006 so that roll-out could move forward once new legislation that extends deposit insurance to banks passes in 2007.

***Donor interventions in the leasing industry should entail a combination of investment and technical assistance.*** A leasing initiative that involves both investment in select leasing companies and wide-reaching technical assistance is a best practice strategy learned by IFC management. Donor technical assistance to multiple leasing companies rather than to one leasing company may also be a more effective approach to stimulate SME development.

***Leasing support services that serve rural and agricultural SMEs are more effective when located in the areas where rural and agricultural SMEs operate.*** Donor interventions that promote leasing industry development may be based in urban areas during the early phase of a project to concentrate on enabling environment issues, but the second phase of donor activities should be implemented in rural areas. This allows donors to more closely coordinate with regional and local players that serve rural and agricultural SMEs.

***Facilitate public education initiatives about leasing and its benefits and risks to effectively impact market supply and demand.*** In the rural areas of Russia, a lack of understanding about leasing still persists. Workshops, seminars and other information distribution channels can be used to disseminate information about leasing as a viable financing option for productive asset investment and how leasing deals are structured. Facilitating linkages among potential lessees, leasing companies and equipment suppliers through seminars, workshops, and trade shows are integral strategy to promoting leasing industry development.

***Best practices to support leasing industry development and integrate leasing into other financial services and rural finance development projects can be shared and leveraged by nurturing closer donor and stakeholder collaboration and coordination and increased research on leasing models.*** Proactive donor and stakeholder coordination is needed on legal and policy reform initiatives to ensure legislative and policy reform consistency across sectors. Scarce information exists on the demand and supply of leasing in rural areas and to agribusinesses. Further research and analysis on successful leasing models will help USAID missions and other donors understand how leasing can be integrated into rural finance and development projects and best reach rural and agricultural SMEs. Making existing studies by donors and leasing associations more widely available through better dissemination is also necessary.

***Advocate portfolio diversification as an effective risk mitigation tool for leasing companies to safeguard against defaults.*** Rather than exclusively target agricultural SMEs or rural areas, successful leasing institutions can better manage risk and portfolio quality by

diversifying their client base geographically and by sector and size of leases. Default rates accounted for less than one percent of the leasing portfolio for several IFC assisted leasing companies interviewed. The low arrears and write-offs among SMEs may be attributed to the fact that productive equipment is too important to client operations to risk losing it by defaulting on lease payments.

***Assist in developing a strong leasing association.*** Strengthening the industry by supporting a sustainable national or regional leasing association that provides legislative advocacy and capacity building to leasing companies is an effective exit strategy for donors, if the industry is large enough to sustain such an association via member dues or other fee-based services. An association can evolve from a leasing advocacy working group as was the case of the North-West Leasing Association, which now functions an advocate on leasing policy and legislation as well as provides training services to industry players in northwestern Russia. Donor assistance in association building is a longer-term commitment since it may take more than five years for the association to become financially sustainable.

# INTRODUCTION

Throughout Eastern Europe and Central Asia rural and agricultural SMEs face the constraint of replacing old machinery or obsolete equipment in addition to the challenges associated with the seasonality of agriculture. While some SMEs are able to obtain working capital, most struggle with inadequate access to the medium or long-term financing they need to invest in newer, better technologies and improved equipment as well as to finance agricultural production. This lack of medium and long-term financing prevents them from undertaking investments that could enhance the scale or productivity of their rural or agricultural SME operations. (In this paper, medium and long-term financing refers to a period of approximately three to five years. While longer-term financing (ten years plus) is common for the leasing of real estate in some countries, the typical lease term offered by the companies examined in this field research was three years.) In the face of such constraints, the development of leasing markets holds much potential to increase the growth and competitiveness of the agriculture sector.

## SCOPE OF REPORT

Can the development of leasing markets effectively expand access to medium and long term financing for SMEs<sup>2</sup> and facilitate rural financial sector deepening?<sup>3</sup> This case study attempts to answer these questions by analyzing innovative uses of leasing as a financing tool to expand rural and agricultural finance (RAF) to SMEs in Russia. The constraints to developing the leasing industry such as tax issues and legal hurdles are also assessed. This study examines successful interventions used to

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<sup>2</sup> There is no single universally accepted definition of SMEs within USAID, other donor agencies and national governments. SMEs are usually defined differently based on regional or country context. According to Russian law, small businesses are defined by number of employees, which varies by sector. The average number of employees (including part-time workers and persons working under sub-contracts) does not exceed the following maximum levels: in building and transport industry (100 employees); agriculture, science and technological fields (60 employees), retail trade and consumer services (30 employees), other fields (50 employees). Russian legislation provides no legal definition of medium-sized enterprises, creating problems related to the statistical monitoring of the SME sector. For purposes of this paper, medium sized enterprises will be defined as those with 100-250 employees.

<sup>3</sup> Edward Shaw, Financial Deepening in Economic Development, (1973), introduced the term *financial deepening* to describe a process of expansion of financial transactions through markets at a pace faster than the growth of non-financial activities. In this report, rural financial sector deepening refers here to an expansion of financial transactions, including leasing services, to rural areas.

tackle policy and legislative constraints to create a more equal playing field for leasing companies. Access to medium and long term finance, the main challenge to leasing industry expansion, is also explored as the study uncovers systemic and non-systemic factors resulting in severe undercapitalization of the leasing industry. The experiences of leasing companies that received technical assistance or investment from International Finance Corporation (IFC), the major donor in Russia involved in leasing industry development, illustrate the main operational challenges faced by leasing companies and how they have been overcome. The study also evaluates the nature of demand for leasing among rural and agricultural SMEs, uncovers the issues inhibiting more rapid growth of SMEs, and highlights the impacts of leasing equipment on SME development. Finally, successful leasing industry development interventions in Russia are analyzed for their replicability in other developing countries.

### **RESEARCH METHODOLOGY**

Data collection in spring 2005 for the case study included a literature review of IFC-related leasing projects and leasing companies receiving IFC technical assistance in Russia and Central Asia, including the Agro-Industrial Finance Company based in Moscow; USAID and other donor interventions in Russia related to financial services and SME development; and background information on Russia's socio-economic situation, financial and agricultural sector and policy, and legal and regulatory environment related to leasing. The researchers developed three survey instruments to target the three distinct groups interviewed: donors, leasing companies, and leasing clients. (See Annex 1). During a three-week field visit in May 2005, the team, composed of Sherry Sposeep, a microenterprise research specialist and Irina Sedova, a research assistant, conducted interviews at the IFC project level to understand project interventions, leasing company level to explore the operational side, and the client level to explore impact of leased equipment and machinery on businesses. The researchers also held interviews with non-financial support institutions to review how support activities have resulted in leasing industry development.

### **STRUCTURE OF REPORT**

The case study report is organized as follows:

**Section I** briefly lays out the purpose of the report, the methodology used in the data collection and analyses and the structure of the paper.

**Section II** establishes the context in which the leasing industry developed in Russia by pointing out critical aspects of the macroeconomic context, the development of the financial sector, and the rural and agricultural SME sector.

**Section III** provides an overview of leasing development in Russia, describes current leasing operations and risk mitigation practices, highlights the extent to which leasing companies have expanded services to rural and agricultural SMEs, and emphasizes key challenges in developing the leasing industry.

**Section IV** examines the history of enabling policy and legislation for leasing in Russia and synthesizes the most relevant lessons learned with respect to the policy, legal, and regulatory environment and tax and accounting issues.

**Section V** proposes recommendations for donor interventions to support the leasing industry, based upon the constraints faced in Russia and lessons drawn from the case study.

# COUNTRY CONTEXT

## MACROECONOMIC SITUATION

Overall, macroeconomic conditions have gradually improved since the 1998 financial crisis in Russia. The economic situation is now more conducive to leasing and SME development, in general. However, it is important to note that Russia's agricultural competitiveness is slipping, making rural and agricultural leasing somewhat less attractive for potential investors.

***Economic Indicators:*** As for any economic activity, steady and positive economic growth and controlled inflation are important conditions for development of leasing services. Economic growth has been strong in Russia for six years, promoting a more stable environment for leasing industry development and SME growth. In 2004, GDP reached \$582.4 billion. Russia has boasted an average annual GDP growth rate of 6.5 percent since the financial crisis in 1998. Russia's rich endowment of natural resources accounts for an estimated five to six percent of the world's proven oil reserves and one-third of global gas reserves, generating oil and gas exports that fuel much of the country's GDP growth. Following an inflation spike to 85 percent in 1998, inflation has steadily declined, decreasing to 11.4 percent in 2004.

***Agricultural Sector:*** Recognizing the important role of agriculture in the Russian economy is critical to understanding the demand for leasing services to agribusinesses. With 133 million hectares of arable land and a large agrarian workforce encompassing 12.3 percent of the 143 million population, Russia is a major regional agricultural player. The country's primary agricultural products are grain, sugar beets, sunflower seed, vegetables, fruits, beef, and milk. While agricultural sector performance has struggled since the Soviet Union collapsed, currently accounting for just 4.9 percent of GDP, a recent rebound of the sector in the last few years has even resulted in overproduction of some food crops, such as grain. Many agricultural experts posit that the agricultural sector will gradually improve, but competitiveness in agriculture hinges upon the country's ability to deal with significant capital asset deterioration, appreciation of the Russian ruble, rapid wage growth, and higher input prices.



***Investment Climate:*** Political stability, investor confidence and financial transparency are necessary for broad-based leasing industry development and SME sector expansion, yet the current climate in Russia threatens accelerated progress on both fronts. Uncertain business-government relations, widespread corruption, an increasing gap between rich and poor, and political instability continue to stifle domestic and foreign investment, which could undermine the leasing industry's potential. Fortunately for Russia, high oil prices are curtailing the slowdown in GDP growth. While foreign direct investment increased by 10 percent between 2003 and 2004, investment still lags far behind other transition economies. Foreign bank investment is heavily concentrated in Moscow and St. Petersburg, leaving the rest of the country's investment potential largely untapped.

## **FINANCIAL SECTOR**

***"Banks are the holy cows in Russia's financial sector—the untouched market. Leasing can not fully develop until the banking sector becomes a true financial intermediary, and long-term debt financing is available."***

***- President of Europlan, a Moscow-based leasing company***

The financial services sector in Russia is largely underdeveloped and inaccessible, particularly to rural or agricultural SMEs. Despite the presence of 1,300 commercial banks in the country, the banking sector is small, with total loans outstanding accounting for only 32.9 percent of GDP in 2003, far below the 100 percent and higher ratios common in most developed market economies. Most of these banks are undercapitalized, with less than \$1 million in capital.

Many commercial banks do not even collect small savings or offer financial services in rural areas. One problem is the dominance of the banking system by state-controlled institutions. The former Soviet savings bank, Sberbank, is the only financial institution with a state deposit guarantee. Sberbank's privileged position attracts more than 70 percent of all retail deposits and leaves the majority of Russian banks severely undercapitalized. New legislation is expected in 2007 that will extend deposit insurance to other qualified banks.

Public confidence in the banking system is rising, but an estimated 40 percent of Russian savings remains outside the banking system. Deposit terms frequently range from 6-12 months, which only enable banks to offer short-term financing, since liquidity risks and asset to liability mismatches hinder more long-term lending.

Consequently, Russian banks do not function as true financial intermediaries, financing less than 10 percent of fixed-capital investment. The private sector's increasing need to replace obsolete equipment with new productive assets fuels demand for medium and long-term financing, and generates strong market appeal for alternatives to bank financing.

The demand for finance among SMEs in rural areas is partially served by international donor interventions, including USAID, TACIS, GTZ, and others, as well as by state funds from regional or federal budgets, short-term commodity credit, informal lenders, and leasing companies. Even so, the demand among SMEs for investment finance from commercial financial institutions outstrips supply in rural regions.<sup>4</sup> Leasing is an alternative financial tool that has increased access to sorely-needed medium and long-term financing by the private sector.

## RURAL AND AGRICULTURAL SECTOR

**SME growth potential:** SMEs were a new phenomenon in Russia just 15 years ago, but the sector is slowly emerging as a source of economic growth. A 2003 study conducted by the Russian SME Resource Center, found that SMEs represented 94 percent of the total number of enterprises in Russia and 54 percent of market share (SME share of total sales revenue).<sup>5</sup> While this finding supports a favorable trend towards future SME sector growth, a separate study conducted in 2002 concluded that SMEs still only account for 10.2 percent of GDP.<sup>6</sup> This percentage is low compared to 50 percent or more for developed market economies, but illustrates the sector's growth potential within an emerging economy. (See Box 1).<sup>7</sup>

<b>BOX 1 RUSSIA'S SME SECTOR SLOWLY EMERGING AS ENGINE OF ECONOMIC GROWTH</b>		
<b>Country</b>	<b>Number of SMEs (thousands)</b>	<b>Share (%) of GDP</b>
Russia	891	10.2
Poland	1,726	48.1
United States	19,300	50-52
European Union	15,770	63-67

**Source:** IFC. *Financial Leasing in Russia Market Survey 2001-2002*. Moscow: 2002.

Several challenges continue to stifle more rapid growth of SMEs and prevent the sector from reaching its potential as a vibrant engine of economic growth. These barriers are further accentuated for rural-based SMEs, which are more geographically dispersed and isolated from urban markets.

**Demand for medium and long-term finance:** The most prominent challenge is the lack of access to finance. Statistics on the actual demand for finance among farm/non-farm SMEs are difficult to obtain as few studies have been conducted that assess the demand for finance

<sup>4</sup> Rainer Schliwa. "Rural Finance in Transition Countries: The Russian Federation." (2003).

<sup>5</sup> Russia SME Resource Center. *Analysis of the Role and Place of Small and Medium Enterprises in Russia: Statistical Reference*, (Moscow: 2004), 3.

<sup>6</sup> International Finance Corporation. *Financial Leasing in Russia Market Survey 2001-2002*, (Moscow: 2002), 18.

<sup>7</sup> Ibid, 18.

among rural SMEs. However, considering that the average age of machinery and equipment is 22 years and that agribusiness production is at only 30-50 percent of potential capacity,<sup>8</sup> the assumption would be that there is an increasing demand for productive asset finance among SMEs.

While some banks have started to finance rural SMEs, a pervasive lack of liquidity in the banking sector limits available debt finance to SMEs. Under-capitalization of commercial banks and the slow pace of restructuring the banking system since the 1998 financial crisis contribute to continued underdevelopment of SMEs. Short-term credit is accessible to some SMEs, but the medium and long-term credit needed as replacement investment for growth and expansion is limited, especially in rural areas. SMEs often do not have the collateral, credit history, or audited financial statements necessary to receive bank-financed loans.

Capital asset wear stifles SME expansion and growth. About 75 percent of fixed assets are obsolete, generating a high demand for capital asset replacement. After the 1998 crisis, many large enterprises were broken apart and divided into SMEs, which are now crippled by old productive assets and require new equipment to operate fully and expand. Most SMEs cannot finance replacement assets out of retained earnings and therefore external finance through long-term-debt capital or leasing is necessary.

Agribusinesses often utilize capital investment models such as supplier relationships. A captive leasing model<sup>9</sup> used by an equipment supplier operating in southern Russia, expands services to the agricultural sector and is able to achieve economies of scale. The supplier established a mechanical technical station, or equipment park, around a large group of farms. Farmers lease the equipment and pay for this usage in-kind, with a percentage of the harvest yield. Box 2 provides a client testimony to the benefits of fixed asset investment through leasing equipment from a commercial leasing company.

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<sup>8</sup> Rainer Schliwa, 19.

<sup>9</sup> In a captive leasing model a subsidiary leasing arm of a manufacturer or dealer is created for the main purpose of providing leasing to its parent company and/or dealer network.

**Risks Specific to Agricultural SMEs:** Seasonal, credit and property risks create difficulties for agricultural SMEs to access finance. Twenty-seven percent of Russia’s population lives in rural areas where agricultural SMEs are an important source of employment. Two-thirds of the country’s rural population generates their income from agricultural activities. However, agricultural SMEs are vulnerable to idiosyncratic, weather-related risks and this constrains their access to finance. In addition, weak regulation and enforcement of the land code discourages creditors from accepting land as collateral, inhibiting the ability of agribusinesses to take out bank loans.

Agricultural SMEs are often unable to meet requirements from financial institutions, such as demonstrating financial transparency, sound management, and profitability, which limits their ability to access finance. Many SMEs manage two sets of records: i) accurate, internal financial records; and ii) official records submitted to tax authorities, which understate business profitability. Leasing companies complain that it is time-consuming and difficult to collect accurate financial data from SMEs to prove their credit-worthiness. Russia’s *Expert* magazine rating agency recently reported that as many as 80 percent of Russian agricultural companies are unprofitable or at least appear unprofitable based on their financial records.

**BOX 2  
BENEFITS OF LEASING**



**Kolkhoz Rodina**, is a collective farm located in Tula, that produces grain, sugarbeet and milk. *Rodina* leases a Swedish-made milk cooling system for its dairy production from a leasing company based in Moscow. The farm also leases combines and other equipment from two government leasing companies and a foreign equipment supplier.

Leasing is the only financial option available to *Rodina*, which can only get a bank loan for up to a year. “Leasing is good if you do not have the money at once because you can make a constant stream of payments,” said the head of *Rodina*. The Swedish supplier has a high-caliber service center located in the region and provides us with training, spare parts, and repairs when needed. If we cannot pay for spare parts right away, it isn’t a problem.”

The impact of leasing productive assets is immediate. The cooling system allows *Rodina* to store milk for several days before transporting it to market, increasing the quality and amount available for sale. Previously, milk often spoiled before it could be transported. The cooling system allows more efficient operations and as a result, *Rodina*’s total profit has increased.

# RUSSIA'S LEASING INDUSTRY

*“Russia is in a growth phase where players are becoming more sophisticated....For the leasing market to develop, certain conditions must be there—tax advantages, the presence of high value movable equipment; and large ticket transactions occurring so that later small ticket leasing can develop.”*

**- IFC Representative Moscow**

## **OVERVIEW OF LEASING INDUSTRY DEVELOPMENT<sup>10</sup>**

The growth of financial leasing in Russia over the past several years demonstrates the market potential for leasing, especially within the agricultural sector. In 2005, leasing market volume was estimated at between \$3-5 billion. (See Box 3). This compares favorably to the estimated \$1.7 billion leasing market in 2001, according to an IFC financial leasing market survey conducted in 2001-2002. Russia's leasing volume in 2004 represented a 0.9 percent share of annual GDP and a 6 percent share of all investment in fixed assets, double the percentage in 2001.<sup>11</sup> These percentages are small by developed country standards where leasing volume averages between 2-5 percent of GDP, but nevertheless demonstrates positive growth for Russia's leasing industry.

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<sup>10</sup> See *Annex 1: Background Information on Leasing* for greater detail on what leasing is, common leasing structures and comparison of the conditions of leasing versus term loans.

<sup>11</sup> *Expert Magazine*, “Russia Leasing Market Survey.” (Moscow: 2004), 6.

**BOX 3**  
**GROWTH OF RUSSIA'S LEASING INDUSTRY**

<b>Year</b>	<b>USD \$</b>
Before 1998	<0.5 million <sup>a</sup>
2001	1.7 billion <sup>b</sup>
2005	3-5 billion <sup>c</sup>

a IFC. Leasing: An Underutilized Tool in Rural Finance. 2004.

b IFC. Financial Leasing in Russia Market Survey 2001-2002, (Moscow: 2002).

c Based upon estimates provided during stakeholder interviews conducted during field visit to Russia, May 2005.

Leasing is a viable and profitable industry in Russia. One company interviewed cited an annual profit margin of 20 percent, although this is falling with rising competition and subsequent lower interest rates. In 2002, as many as 550 leasing companies were estimated to be operating in Russia, according to licenses granted through 2001. The caveat to this number is that it likely includes many leasing companies that received a license to conduct one leasing deal and are not exclusively providing leasing services. One Moscow-based leasing company estimates only around 100 leasing companies really matter in terms of total market share.

The leasing industry is characterized by different types of lessors, both private and government-owned. Russian banks created many leasing companies at the onset of industry development, but these companies have since expanded their client base and financing sources and some have become independent leasing companies. Foreign banks also set up some leasing companies, although they will unlikely dominate the future market since they will want to contain Russian country risk exposure. Large, financial industrial groups, such as Rostelcom and Lukoil played a role in establishing leasing companies, specifically to supply equipment to companies within the group, but as the leasing industry develops and can adequately serve the needs of this market segment, it won't make operational sense for financial industrial groups to continue engaging in leasing activities, and this service can be outsourced for greater efficiency.

Captive leasing companies or supplier-owned leasing companies, both Russian and foreign, are becoming more common. Foreign equipment suppliers, such as Caterpillar, John Deere, and Klauss, will likely play an increasing role in the Russian market. The captive leasing company model is effective in that the manufacturer and dealer network have a specialized knowledge of the client base, which permits stronger risk analysis. The suppliers are often geographically positioned closer to the lessees than in other leasing models. Leasing companies established by private individuals do not constitute a large share of the current leasing landscape, but are key regional players that meet the financial services needs of underserved pockets of SMEs. There are also government-owned leasing companies, operating on either a commercial or non-commercial (low interest rates, not profit driven) basis.

IFC has been a major player in jump-starting and supporting Russia's leasing industry, through investment to five leasing companies, targeted technical assistance to the Agro-Industrial Finance Company (AFC), market research, and training and other public education initiatives to leasing industry stakeholders. (See Box 4). In addition, IFC was instrumental in facilitating a supporting enabling environment for leasing to flourish. This will be discussed in more detail in Section IV.

**BOX 4**  
**IFC ASSISTANCE TO THE LEASING INDUSTRY**

IFC began providing technical assistance to the leasing industry in Russia in 1997 through the Russia Leasing Development Group (RLDG) project, funded by the Canadian International Development Agency (CIDA) and the British Know-How Fund (BKHF). Other IFC leasing projects are the North-West Russia Leasing Development Group (2002-present), which is creating a leasing package of services that will be used to train leasing companies, lessees and suppliers in other countries and regions where the donor operates and the Agri Leasing Promotion Project, which ends in 2005, has promoted agricultural leasing and provided technical assistance to the Agro-industrial Finance Company (AFC). IFC is conducting market research on the barriers to leasing industry development in Russia.

IFC investment in the Russian leasing market began in 1999. To date, IFC has invested \$19 million and mobilized \$45 million from Western co-investors in five Russian leasing companies:

Deutsche Leasing Vostok - \$0.6 million of equity investment and \$3 million loan

Europlan, formally Delta Leasing - \$10 million loan

Delta Leasing, formerly DeltaLeasing Far East - \$3 million loan

Baltic Leasing \$2 million loan

Agro-industrial Finance Company (AFC) - \$0.5 million of equity investment, \$5 million loan and \$10 million syndicated loan

Source: [www.ifc.org](http://www.ifc.org) and interviews with IFC-Russia in May, 2005.

In 2004 *Expert* magazine conducted a leasing market survey, in which 110 leasing companies in Russia participated. The survey revealed that sixty-three of these companies engage in leasing to food processors, yet only thirty-seven of these companies engage in agricultural leasing. Market penetration to the agricultural production sector is low due to seasonal risks, lack of profitability of agribusinesses, and increased competition with the state-subsidized leasing company. The survey further distinguished how many leasing companies serve rural versus urban areas, and found that while most leasing companies are still located in the European region of Russia, there is a trend towards expansion of leasing activities in the Urals region, Siberia and the Far East. Twenty percent of leasing companies surveyed in 2004 operate in the Moscow region, 19 percent in the Volga region, and 12 percent in the St. Petersburg region.

According to the 2004 Leasing Survey conducted by *Expert* magazine (See *Annex 3 2004 Leasing Sector Survey Results*), Russia's total leasing

portfolio is broken down into telecommunications equipment (20 percent); trucks (10 percent); passenger cars (10 percent); railroad equipment (8 percent); food processing equipment (4 percent); wood processing equipment (4 percent); and agricultural equipment (2 percent).

### **RISK MITIGATION PRACTICES IN LEASING COMPANIES**

Leasing companies employ a range of risk-mitigation techniques and policies to limit risk exposure and protect against default and arrears and write-offs have generally been smaller in Russia's leasing industry than those of traditional lenders. This section explores how Russian leasing companies have incorporated risk mitigating practices such as portfolio diversification, rigorous risk analysis through credit scoring and other non-automated systems, buy-back agreements, remarketing agreements and insurance.

### **PORTFOLIO DIVERSIFICATION, THOROUGH RISK ANALYSIS, AND FLEXIBLE REPAYMENT SCHEDULES**

*First and foremost, leasing companies maintain portfolio quality by limiting portfolio concentration and diversifying risks.* . Few private leasing companies engage exclusively in leasing to the agricultural (production and/or processing) sector. Many leasing companies manage diversified leasing portfolios from sectors including wholesale and retail operations, food and beverage processing, construction, forestry, automobile manufacturing, furniture production

For example, Baltic Leasing, the first commercial leasing company in Russia, limits portfolio concentration in any one sector to 25 percent to mitigate against defaults. (See Box 5).<sup>12</sup> Other leasing companies have implemented policies which prohibit leasing deals which exceed a maximum equity of the firm or require board approval for these larger

<b>BOX 5</b>	
<b>SNAPSHOT OF BALTIC LEASING (AS OF 12/2004)</b>	
<b>Headquarters:</b>	St. Petersburg
<b># of branches:</b>	7, Moscow, Kirov, Pskov, Krasnodar, Yekaterinburg, Samara
<b>Total # of staff:</b>	80
<b># of active leases:</b>	523, 50% are rural-based
<b>Volume of lease portfolio (USD):</b>	\$57.1 million
<b>Share (%) of total amt of lease contracts:</b>	Headquarters (73%); Regional offices (27%)
<b>Avg. lease term:</b>	36 months
<b>Interest rates:</b>	14-25%
<b>Type of equipment leased:</b>	Vehicles (27%), construction (18%), metal processing (16%), agricultural, loaders, wood processing, food industry, electric power, print, plastic manufacturing
<b>Funding Structure:</b>	90% (debt); 10% (equity)

<sup>12</sup> Interview with Baltic Leasing on May 27, 2005.



deals.

***Leasing companies that practice stringent risk analysis create healthier portfolios and reduce the chances of default.*** Risk analysis of a leasing deal focuses on the enterprise's cash flow, liquidity of the equipment, and character analysis. Leasing companies evaluate potential clients based upon: (1) character analysis – clients with a good reputation; (2) liquidity of equipment and resale value in case of repossession; and (3) cash-flow. Cash-flow analysis allows a leasing company to thoroughly assess potential clients, more than simply using collateral-based analysis. As an IFC program manager explained, "The key issue is the idea that you can set up leasing with cash flow as the main collateral." This is attractive to SMEs that do not have additional collateral to pledge against a loan in traditional bank financing.

***Designing repayment schedules appropriate to the cash flow of agribusinesses is a common risk mitigation strategy.*** Baltic Leasing offers leases in the agricultural sector. To mitigate against default, Baltiski structures more flexible repayments schedules to lessees due to the seasonality of agribusinesses, requiring smaller payments in spring and summer and larger payments in fall during harvest.

#### **EFFECTIVE MONITORING TO REDUCE RISK**

Leasing companies are trying to match appropriate technology with institutional capacity to achieve economies of scale. Foreign technological systems may not be appropriate to a local context, however, it is helpful for leasing companies to learn what is available on the market, and then adapt systems to the local environment. Some leasing companies use a credit committee methodology for approving leases while more advanced leasing companies rely upon automated credit scoring systems. (See Box 6).

#### **BOX 6**

##### **EUROPLAN USES AN AUTOMATED SCORING MODEL TO MORE EFFICIENTLY EXPAND SERVICES TO SMEs**

Europlan has developed two risk analysis methods depending on the level of financial transparency of lessees. The first analysis method is used for clients without official audited statements. This method analyzes the deal based on managerial data (equipment valuation, credit history and cash flow) and scores up to \$50,000. No business plan is required. The second method is used for clients with official audited financial statements and scores are much higher. Both options offer larger leases to good, repeat clients. When lease applications are rejected, Europlan explains the reasons why and gives potential clients the option to address the issue and reapply for a lease.

***A management information system (MIS) that is well-designed and implemented can alleviate potential problems of default during the leasing term.*** Leasing companies need to adequately monitor clients and equipment. This includes an automated MIS, which signals late payments to help staff manage the portfolio. While

small, one-shop leasing companies with few clients may use non-automated MIS, an automated MIS is necessary as the client base grows and/or the company expands its branch network. For example, a small Moscow-based leasing company with a client base under 20, but with a portfolio of almost \$11 million recently installed an automated MIS to improve leasing tracking and reporting, monitor late payments, and prepare the company for future expansion. Another leasing company serving over 1,500 clients requires use of automated MIS to track and follow up on late payments.

***On-site monitoring of equipment poses challenges for leasing companies working with specialized machines, such as agricultural processing equipment.*** Rather than on-site monitoring of all clients, which absorbs tremendous time and resources, one approach used by a leasing company is to selectively monitor clients based on their risk profile. An active, committed, and competent supplier can advise and monitor the client's business.

***Leasing companies that work with agricultural producers evaluate potential clients' relationships with processors and equipment suppliers.*** Equipment is considered riskier than passenger car leasing because of the entrepreneurial element. Therefore, an initial increase in passenger vehicle leasing may occur during the nascent stage of industry development as companies learn how to assess basic risks for equipment with a secondary market before leasing more specialized equipment requiring more advanced risk analysis and valuation.

***Some leasing companies attest that equipment suppliers located closer to lessees permits more effective monitoring and support, which can result in higher client satisfaction and on-time payment.*** Lessees value quick equipment installation, effective training on equipment if required, and dealers located nearby, should spare parts or equipment repair be necessary.

#### **CONTRACTUAL MECHANISMS TO REDUCE RISK**

##### ***Buy-back and remarketing agreements can mitigate risks.***

Leasing companies use a variety of mechanisms to minimize risks including buy-back and remarketing agreements, suretyships, collateral in addition to leased equipment, and insurance. Securing a buy-back agreement in which the dealer commits to buy back the equipment, from the leasing company in case of lessee default can be difficult to obtain when the secondary market for the equipment is undeveloped. If the dealer won't accept these conditions, leasing companies may negotiate a remarketing agreement, which obligates the dealer to resell the equipment in case of lessee default. Often equipment suppliers are unwilling to share the credit risk. Another risk mitigating tool used by leasing companies is a suretyship contract. A suretyship is a contract in which a guarantor is liable for the debt or default of a lessee.

#### **INSURANCE**

Leasing companies recognize that insuring the leased asset and in some cases the collateral is an important risk mitigation strategy. There are

several types of insurance that leasing companies may use, including third party liability insurance, loss and damage insurance, and political risk insurance. The costs of these insurances may either be passed on to the client or cost shared between the lessor and lessee.

#### **MITIGATING EXCHANGE RATE RISK**

When companies lease foreign equipment, the interest rate is often kept adjustable to limit their own risk exposure and pass the foreign exchange risk on to clients. The risk for large agribusinesses exporting commodities on the foreign exchange market is less than for smaller enterprises that have more difficulty assuming the cost of rising lease payments due to currency fluctuations.

#### **EXPANDING LEASING TO MSMEs AND AGRIBUSINESSES**

*“Leasing is good if you do not have the money at once because you can make a constant stream of payments. Leasing is the only financial option available to us. We can only get a bank loan for up to a year.”*

##### **- Leasing Client of Agro-industrial Finance Company**

In 2001, IFC conducted a survey, which revealed that leasing companies are responding to the demand for finance among SMEs. Of the 114 leasing companies that participated in the survey, 78 percent serve SMEs and the average number of SME leasing deals per company was 44.<sup>13</sup> Leasing companies serving SMEs generally offer leases starting at between \$50,000-100,000. Some financial institutions offer micro-leases to micro and small enterprises. Micro-leases range in size and are generally \$500 to \$25,000. However, micro-leasing activities remain a small part of the total leasing portfolio and the financial institutions offering micro-leases tend to be less integrated into the leasing industry.

In general, leasing companies are becoming more sophisticated and customizing leasing deals to reach the growing SME market, and are starting to tailor leasing deals to client needs to become more competitive in the growing leasing market, in terms of lease terms, currency, grace periods, repayment schedules, and insurance, collateral, and other risk management strategies. Leasing deals may be structured in rubles or linked to a hard currency, depending on the currency of the equipment purchased. Contract terms regarding installation, training on the equipment, and equipment repair and maintenance are defined in the contract, but are usually the dealer’s responsibility.

***Small and medium sized leases are lucrative for leasing companies because of the higher profit margin on smaller deals.***

One leasing company described their profit margin as ranging from as high as 45 percent for small deals. The high demand for sophisticated equipment among SMEs is generated by the need to more fiercely compete against larger enterprises for market share. Capital asset

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<sup>13</sup> International Finance Corporation. *Financial Leasing in Russia Market Survey 2001-2002*, (Moscow: 2002), 18.

investment, automation and technological upgrades can lead to streamlined operations, increased production, quality, efficiency, and profitability for SMEs.

From the supply side perspective, one advantage of serving this market

**BOX 7  
EUROPLAN LEASING EXPANDS TO  
RURAL SMEs IN KRASNODAR**

Europlan's Krasnodar branch is located in a region where 85% of fixed assets are obsolete and equipment investment is in high demand. The branch was set up in 2003 and currently manages almost 200 leasing clients. Twenty five percent of clients are located in rural areas, but the branch is trying to expand leasing services to rural SMEs that badly need their services.

Leases are primarily in construction, food and beverage production, and wholesale/retail trade. In the agricultural sector enterprises range from egg powder processing to wine, nut and ice cream production.

Krasnodar's branch manager boasts that "Lease applications for small clients for leases under \$100,000 can be processed in as fast as five days, while it still only takes two weeks for large applications." This is an important benefit for SMEs who often need equipment immediately and can not afford to wait months for bank loans to be processed.

with such high, unmet demand for finance is that MSMEs are willing to pay higher interest rates for services. This is a short-term advantage, though, and as competition in the leasing industry and financial services sector as a whole grows, leasing companies may need to lower interest rates to compete. This will require leasing companies to create more streamlined processes to reduce operational expenses to maintain profitable margins.

Europlan, a Moscow-based leasing company with a branch network has confronted the challenge of working with SMEs that operate in the informal sector by offering smaller, first time leases to enterprises without audited financial statements. The size of lease deals increases for repeat clients- an incentive for on-time payments. (See Box 7). Europlan (see Box 8), the largest car leasing company in Russia, with equity funds exceeding \$30 million, has successfully attracted over \$85 million in debt financing from leading financial institutions including IFC, US Exim Bank, EBRD OPIC, and the International Moscow Bank. Europlan targets SMEs and small ticket lease transactions, mainly indexed to the USD.<sup>14</sup>

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<sup>14</sup> Interview with Europlan on May 14, 2005.

**BOX 8**  
**SNAPSHOT OF EUROPLAN (AS OF MARCH, 2005)**

<b># of active leases:</b>	>4000
<b># of branches:</b>	8
<b>Average amount of lease (USD):</b>	\$50,000
<b>Average down payment:</b>	25%
<b>Average lease term:</b>	30 months
<b>Geographic portfolio distribution:</b>	Central Russia (58%); Volga (13%), (as % of net lease investments) Southwest (11%), Northwest (11%), Urals (6%), Siberia (<.5%), Far East (<.05)
<b>Type of equipment leased:</b>	Transportation vehicles (58%); food production, metal work, printing, wood processing, restaurants, and packaging materials
<b># of industries served:</b>	39
<b>Funding structure:</b>	\$85 million (debt); \$30 million (equity)

**LEASING TO THE AGRICULTURAL SECTOR**

Most leasing companies are still hesitant to enter the agricultural sector, especially at the producer level. *Expert* magazine's 2004 leasing market survey revealed that only thirty-seven of the 110 companies interviewed engage in agricultural leasing. This is due to perceived and actual risks including seasonal risks, low returns on serving this sector, and competition with Rosagroleasing.

*The state-owned Rosagroleasing dominates the agricultural leasing sector with an active leasing portfolio over \$850 million<sup>15</sup> and distorts market forces through subsidized, below market interest rates.* This public leasing company was established in 2001, replacing Rosagrosnob, the former state-subsidized monopoly in the agricultural sector. Initially Rosagroleasing leased only domestically produced combines, tractors, and other equipment, but they recently signed a \$25 million credit facility with John Deere, guaranteed by the U.S. Exim Bank, allowing them to lease foreign equipment. Rosagroleasing attracts many agribusinesses willing to endure a lengthy application process for below-market interest rates. To compete, some private leasing companies have developed a market niche through product differentiation, better customer service, and/or faster processing time.<sup>16</sup>

On the other hand, some leasing companies are increasing deal flow to agribusinesses along targeted value chains by leasing agricultural equipment and vehicles. Leasing companies don't typically track such indicators as the number of leases to rural versus urban client. However, while companies may not describe their operations as reaching rural areas, they often do. With the addition of leased equipment, agro-processing businesses based in peri-urban or rural

<sup>15</sup> "John Deere enters into agreement with Russian Leasing Company." [http://www.deere.com/en\\_INT/europe/press/rosagroleasing.html](http://www.deere.com/en_INT/europe/press/rosagroleasing.html), (December 21, 2004).

settings may increase production, generating employment and other economic impacts in the rural economy.

The Agro-Industrial Finance Company (AFC) is one of a few specialized leasing companies involved in leasing to agricultural production and processing SMEs. AFC, a small Moscow-based leasing company specialized in the agricultural sector, attracts clients by offering foreign as well as locally produced agricultural equipment. This initially was a strong competitive advantage over the government leasing company, which previously only offered Russian-made equipment, but has since begun leasing some foreign equipment. Within AFC, there is currently a trend away from financing primary production and toward financing agricultural processing because the cash flow in processing is more stable and the deals are more profitable than in primary production. (See Box 9).<sup>17</sup>

<b>BOX 9</b>	
<b>SNAPSHOT OF AGRO-INDUSTRIAL FINANCE COMPANY (AFC)</b>	
<b>(AS OF 3/2005)</b>	
<b># of staff:</b>	9
<b># of active leases:</b>	11, in rural areas
<b>Volume of lease portfolio (USD):</b>	\$10.8 million
<b>Lease terms:</b>	36-60 months
<b>Type of equipment leased:</b>	Combines, tractors, cultivators, sowing machines, fertilizer spreaders, ploughs, packaging, railroad cars, trucks, dairy producing and processing
<b>Funding Structure:</b>	90% (debt); 10% (equity)

### **THE CHALLENGES FACING LEASING INDUSTRY DEVELOPMENT IN RUSSIA**

The leasing industry is developing as a financial alternative to the limited medium and long-term bank financing available in Russia. However, growth in this industry is constrained by the leasing companies' need to attract both debt and equity finance to capitalize their portfolios and fund new leasing deals. Undercapitalization and access to on-going finance to expand portfolio growth and meet the growing market demand is a big challenge for commercial leasing companies. Many companies struggle to attract and build their equity base. Lack of available debt financing by domestic banks prompts some leasing companies to explore foreign finance options to capitalize operations.

***Lack of knowledge about leasing--its benefits and risks-- persists in rural areas.*** IFC has organized seminars and trainings to educate suppliers, agricultural and financial companies, government officials,

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<sup>17</sup> Interview with AFC staff on May 12, 2005.

and SMEs on the advantages of leasing as an effective financial instrument for enterprise development, but outside of Moscow, St. Petersburg, and other major cities, increased knowledge about leasing is needed.

***The lack of financial transparency among leasing companies constrains access to finance.*** Savvy investors are interested in leasing companies that demonstrate financial transparency, use International Financial Reporting Standards (IFRS) and possess the regional knowledge to profitably facilitate deal flow. Leasing companies that only use the Russian accounting system do not provide a transparent picture of their financial situation and limit their opportunities to secure foreign finance.

***Secondary markets for leased equipment are scarce except for movable assets, such as cars, tractors and combines.*** The underdeveloped secondary market for equipment poses a challenge to mitigating risks for leasing companies. Leasing companies want limited risk exposure in leasing deals and the absence of mature secondary markets for most equipment creates additional risks. Since leasing companies generally assume more equipment risk than other financial institutions, price stability for equipment is a central issue. The secondary market in Russia is more developed for passenger vehicles than for agricultural processing and other types of equipment, attributing to the heavier volume of car leasing among leasing companies. Equipment in some sectors, such as poultry and food processing, is highly specialized, tailored to an enterprise's needs, and difficult to move and resell.

Europlan had developed an innovative policy regarding reselling equipment in cases of default. Rather than repossessing the equipment and reselling or re-leasing it themselves, Europlan allows clients to resell the equipment themselves to secure the best price. This approach has both the advantage of transferring the reselling responsibilities and costs onto the client, thus lowering Europlan's operating expenses, and allowing the client to continue generating revenue while searching for potential buyers. One potential disadvantage of this approach is that a lessee may spend time and effort selling equipment that was not useful to the business and therefore won't benefit from an arrangement that allows for keeping the equipment longer.





An animal fodder production company leases equipment (photo below) outside Krasnodar, Russia.



#### **FINANCIAL INFRASTRUCTURE FOR LEASING STILL IN NASCENT STAGE**

*Russia's leasing industry needs a stronger financial infrastructure to reduce information asymmetries in the market.* For example, there is no national credit bureau in Russia for leasing companies or other financial institutions. One leasing company manager suggested it would be useful for leasing companies to exchange information on bad borrowers and fraudulent activities of clients. Without a national credit bureau, leasing companies strive to utilize all available information to conduct risk analysis, including the client's financial statements, information from the tax office and customs office, and financial institutions. More mature leasing companies and leasing subsidiaries of banks have internal credit facilities that perform this function.

*Public information on leasing would be useful to the industry because it would arm the private sector with up-to-date statistics and analysis on key trends in the industry.* *Expert* magazine, a weekly Russian publication that analyzes events and trends affecting business, politics and economics, provides quarterly ratings of leasing companies.

#### **ROOM FOR MORE DEVELOPMENT OF NON-FINANCIAL INFRASTRUCTURE**

The American Chamber of Commerce Leasing Committee, Rosleasing, and North-West Leasing Association evolved from earlier legislative activities that now provide advocacy and/or training services to their members based primarily in Moscow or St. Petersburg. Unfortunately, there is a lack of collaboration between these associations, particularly in the area of training and support services to constituents, which weakens industry development as a whole.



Greater coordination among these leasing associations and/or the development of a national leasing association could improve information sharing and facilitate industry growth. A national association could serve an important advocacy role on leasing policy and legislation and strengthen the capacity of leasing industry players through training and support in legal and accounting issues, financial management, international accounting standards, and other topics.

***Rural- based leasing companies demand advocacy and training services but most business development services (BDS) are largely inaccessible to them.*** The North-West Leasing Association has conducted approximately 25 educational activities (i.e., seminars, roundtables, and trainings) to its membership in the St. Petersburg area. (See Box 10). The American Chamber of Commerce Leasing Committee provides advocacy and other support services to Western-financed leasing companies mainly in Moscow and Rosleasing, a Moscow-based association, headed by the director of state-owned Rosagroleasing, provides similar services to its members. In addition, a regional leasing association is developing in the Ural region. Even so, leasing companies located outside Moscow and other urban centers have difficulty accessing these businesses development, legal, and advocacy services.

**BOX 10**  
**OVERVIEW OF NORTH-WEST LEASING ASSOCIATION**

The Northwest Leasing Association was established in St. Petersburg in 1999 as the first regional leasing association in Russia. This locally-run association is self-financed through membership dues and training fees. It provides trainings in leasing specialization and facilitates and organizes seminars, workshops, some in joint collaboration with IFC, and roundtables for leasing professionals. Seminar topics range from the “Fundamentals of Leasing” to “Accounting and Taxation of Leasing Assets” and “Legal Aspects of Leasing” and are presented by leasing professionals. The association also has an extensive consultation network, providing advisory services to over 700 members. The Association is in the process of obtaining a license to establish the first Russian leasing education center.

## **DEVELOPING AN ENABLING ENVIRONMENT FOR LEASING**

### **EVOLUTION OF LEASING LEGISLATION IN RUSSIA**

Today the policy, legal and regulatory framework for leasing is relatively developed and leasing companies rarely cite legal and regulatory issues as a major hindrance to operations. This is due to the efforts of multiple stakeholders, including the private sector, government, and donors, in advocating for a transparent enabling environment to ensure the industry’s long-term stability and growth.

Before 1998 however, leasing activity in Russia was hampered by contradictory legislative acts and regulations. When the State Duma adopted the 1998 Law “On Leasing,” the law unfortunately contained

numerous provisions that conflicted with the Civil Code, the Unidroit Convention on International Financial Leasing, and other legislation on taxation and customs. The legislation further constrained the leasing industry because it created an unfair playing field in which operating costs for leasing companies were about 30 percent higher than for banks.

IFC's Russia Leasing Development Group (RLDG) project (1997-2002) in coordination with other key leasing stakeholders, including the American Chamber of Commerce Leasing Committee, European Business Club, Duma Committee on Leasing, and others, then drafted amendments and framework agreements to resolve both internal contradictory provisions and contradictions that existed among the various legal acts. When the 2002 Federal Law "On Amendments and Addenda to the Federal Law on Leasing," passed, it substantially reduced the investment risks created from legal and tax uncertainties and established a stronger legislative base for the leasing industry to develop.

***Political will and support of leasing reforms was crucial to pushing through amendments.*** The support of key policy champions in the Russian government and legislature to develop leasing was an integral aspect of Russia's success in amending the previously contradictory leasing legislation. In particular, the interest and support of the Deputy Chairman of the Duma Committee on Industrial Policy in advocating for leasing amendments was instrumental in carrying through the reforms. Coordination among leasing companies, financial institutions, law firms, government, and other stakeholders who brought their own interests to the table helped to ensure that all perspectives were considered and represented during the legal, regulatory and policy reform process.

#### **LEGISLATIVE REFORMS IN RUSSIA**

Four legislative reforms led to a more conducive environment for leasing in Russia. They include the following:

- Legislation that clearly defines a lease contract, leased assets, and responsibilities and rights of parties to a lease contract.
- Abolition of the law for licensing of leasing companies, which created a bureaucratic constraint rather than protection against illegal activities.
- A favorable tax policy that permits accelerated depreciation for leased property and expensing of lease payments.
- Abolishment of all turnover taxes on sales revenue.<sup>18</sup>

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<sup>18</sup> Turnover taxes were a particular burden to leasing companies, which often generate high revenue on relatively small margins.

### **DEFINITION OF “LEASING” IN RUSSIA**

The term “Leasing” is clearly defined in Russia. The Civil Code creates the legal foundation for financial leasing, forms the basis for additional specific legislation, and defines leasing as:

*“Under a leasing agreement the lessor is obligated to acquire property indicated by the lessee from a seller stipulated by him and to supply this equipment to the lessee in return for payment for temporary possession and use for entrepreneurial purposes. The lessor in this case does not bear responsibility for the choice of the leased asset and the seller. A financial rental agreement may state that the choice of the seller and the equipment is made by the lessor.”*

This rule-based definition of a leasing agreement establishes the following qualifying factors for a leasing deal:

- Financial leasing is a three-sided relationship among the supplier, the lessor, and the lessee.
- There is broad freedom of contract with a minimum of two legal agreements.
- The leased asset should be used for entrepreneurial purposes only.
- Property should be acquired specifically for leasing purposes.
- Leasing refers only to financial leasing or capital leasing. Operational leasing is considered rent and is not included in this definition.
- Leasing agreements that do not meet the tests in the above definition are not considered leases, although they may clarify as rent agreements.

### **NO PRUDENTIAL REGULATIONS OF THE LEASING INDUSTRY**

There are no prudential regulations imposed on leasing companies in Russia. In fact, anyone can lease and registration is not required. Licensing of leasing activities created a bureaucratic bottleneck, which impeded industry development. Lengthy licensing procedures led to the delayed entry of legitimate leasing companies, rather than the barring of incompetent leasing companies from entering the industry. Licensing was ultimately lifted since leasing companies do not place the public at risk by mobilize public deposits. This has had a positive impact on the leasing industry by increasing the number of industry players and creating a more competitive environment.

### **TAXATION AND ACCOUNTING ISSUES**

The advocacy initiatives of IFC and other key stakeholders in Russia on tax code reforms have accelerated industry growth. The enforcement of Chapter 25 of the Tax Code in 2001 regulated the mechanism for calculating and levying profit tax and contained the following changes:

- 1) a reduction of profit tax from 35 to 24 percent;
- 2) an elimination of most tax breaks, including those for capital investment;
- 3) changes to the calculation of depreciation;
- 4) the removal of restrictions on deducting expenses; and
- 5) a new system for deducting interest expense.

The tax reforms further retained key principles of the existing tax treatment for leasing, which stimulated initial leasing industry development.

The main tax advantages to leasing are: (1) the flexibility to record an asset on either the balance sheet of the lessor or lessee, (2) accelerated depreciation of the asset up to a factor of 3, lowering profit and property taxes, and (3) the ability of lessees to fully expense leasing payments, lowering the taxable profit base. Lessees include lease payments in the cost of production, which lowers their profit tax payable.

***Lower VAT taxes facilitate leasing industry growth.*** VAT has been lowered in Russia to 18 percent. Further reduction of VAT to 15-16 percent is anticipated in 2006 and will pave the way for additional leasing industry development and boost foreign equipment leasing.

***While all leasing payments in Russia are subject to VAT, the lessee can record VAT paid as a tax deduction and is entitled to government reimbursement within three months.*** If the VAT claimed for reimbursement is a large sum, tax authorities may scrutinize the deal as possible fraud. Currently, the VAT reimbursement practices of regional tax authorities vary and the difficulties raised among leasing companies reflect this. Many agricultural enterprises are exempt from VAT and therefore simply expense VAT paid as part of a leasing payment.

## **REMAINING CHALLENGES STILL AFFECTING THE LEASING INDUSTRY**

Progress has been made on establishing a sound policy, legal and regulatory environment for leasing in Russia. However, in addition to the industry challenges discussed earlier, several challenges remain, some of which may negatively impact the leasing industry.

***First, a lease-back agreement<sup>19</sup> is not defined as a separate type of leasing in legal terms.*** Lease-back agreements, which allow clients to unfreeze working capital, are legal according to law, but are addressed differently in the leasing law and the Civil Code. According

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<sup>19</sup> This is also referred to as a *sale and leaseback*.

to Civil Code, leasing must be a three-sided relationship among the seller (supplier), lessor and lessee. In a lease-back agreement, there are only two parties – the lessor and lessee. Leasing companies that engage in lease-back agreements may interpret that since priority is given to specific codes (Law on Leasing) over general codes (Civil Code) in Russia, a lease-back agreement has legal precedence. As a result, few leasing companies utilize lease-back agreements.

***A lack of clarity still exists with regard to the method for recording an asset on the balance sheet.*** This haziness has caused inconsistent interpretations and practices among leasing companies, who may carry the asset on either the balance sheet of the lessor or lessee. For leasing companies that record the asset on the balance sheet of the lessee, problems may arise if the contract is breached and the lessor tries to repossess the asset, since the process of withdrawing the asset from the records of the lessee is not formalized by law.

***Weak property rights laws make repossession difficult.*** Recently, a government agency issued an ambiguous directive regarding accounting procedures for leasing. The directive stated that if the leased asset is on the lessor's balance sheet, the lessor does not have to pay property tax on the asset, which is contradictory to the current law. This directive is not a law, but some leasing companies are concerned that if they follow this directive, they may have to pay for unpaid property tax in the future. Therefore, these companies prefer to pay the tax now to avoid possible lump sum payments and penalty fees later.

Relatively simple and fast repossession of leased assets is a key advantage that leasing has over lending operations. However, weak property rights enforcement in Russia has caused some leasing companies to encounter difficulty in repossessing equipment when the lessee violates conditions of the leasing agreement. The problem tends to focus on the amount of time and effort required to repossess the equipment through the court. One leasing company reported that it takes three months to one year to repossess equipment and multiple trips to court. Some leasing companies structure leasing deals so that the lessee has no interest in retaining the assets so returns it uncontested in cases of bankruptcy.

# HOW CAN DONORS SUPPORT LEASING INITIATIVES: LESSONS LEARNED AND RECOMMENDA- TIONS

***Encourage an appropriate legal and regulatory environment, conducive for potential leasing players to enter and exit the leasing market.*** A licensing regime is a bureaucratic barrier that may actually prevent or delay the entry of leasing companies rather than protect the market from corrupt or weak companies from entering. A level playing field for leasing companies to profitably operate and compete fairly is necessary particularly with regards to receiving the same VAT and customs duty treatment as provided to other financial institutions. Sound, transparent, and consistent legislation on leasing can reduce investment risks and uncertainties that impede leasing industry development. The objective of this project is to develop a useful tool to assess an MFI's social performance.

***Support a clear tax policy that has advantages to the leasing industry to provoke the demand and supply side of the leasing market.*** While the leasing industry in some developed countries has expanded without the presence of advantageous tax treatment on leasing, beneficial tax treatment is often needed to spur industry growth. Identify and coordinate closely with a policy champion to push through a policy reform agenda. A policy champion can contribute political insight and an effective approach to tackling institutional

change. Champion(s) who are responsive and open to working with key stakeholders are also crucial to generating a participatory process that includes opportunities for discussing, drafting, and finalizing policy reform. Once tax policy is reformed, engage local governments especially tax authorities to explain how leasing operates and the benefits it can have on the local economy to lessen the scrutiny regarding leasing activities and create a more transparent environment.

***Socially responsible investors and financial institutions demonstrate the viability of leasing as a financing option by investing in leasing companies that develop the industry.*** In Russia, IFC has been instrumental in developing and promoting the leasing industry through equity and debt investment. IFC provided equity financing of \$3 million to establish AFC to enhance leasing to the agricultural sector. AFC has two other shareholders—Rabobank and Netherlands Development Finance Company (FMO). AFC has \$1.5 million in equity shared among three shareholders and \$15 million in loan capital, from its three shareholders, in which IFC assumes the syndicated risk.

***Market-oriented guarantees, such as USAID's Development Credit Authority (DCA), can be used in conjunction with technical assistance to generate greater access to finance among leasing companies.*** “Money is the raw material of the finance industry,” as one leasing company president in Russia said. A guarantee facility could support a commercial bank's extension of long-term loans to viable leasing company partners. USAID missions can consider use of DCA to leverage domestic long-term bank financing to leasing companies to achieve strategic objectives, such as expanded services to rural areas, SMEs and agribusinesses. In the case of Russia, preparation for a DCA loan guarantee could begin in 2006 so that roll-out could move forward once new legislation that extends deposit insurance to banks passes in 2007.

***Donor interventions in the leasing industry should entail a combination of investment and technical assistance.*** A leasing initiative that involves both investment in select leasing companies and wide-reaching technical assistance is a best practice strategy learned by IFC management. Donor technical assistance to multiple leasing companies rather than to one leasing company may also be a more effective approach to stimulate SME development.

***Leasing support services that serve rural and agricultural SMEs are more effective when located in the areas where rural and agricultural SMEs operate.*** Donor interventions that promote leasing industry development may be based in urban areas during the early phase of a project to concentrate on enabling environment issues, but the second phase of donor activities should be implemented in rural areas. This allows donors to more closely coordinate with regional and local players that serve rural and agricultural SMEs.

***Facilitate public education initiatives about leasing and its benefits and risks to effectively impact market supply and demand.*** In the rural areas of Russia, a lack of understanding about leasing still persists. Workshops, seminars and other information distribution channels can be used to disseminate information about leasing as a viable financing option for productive asset investment and how leasing deals are structured. Facilitating linkages among potential lessees, leasing companies and equipment suppliers through seminars, workshops, and trade shows are integral strategy to promoting leasing industry development.

***Best practices to support leasing industry development and integrate leasing into other financial services and rural finance development projects can be shared and leveraged by nurturing closer donor and stakeholder collaboration and coordination and increased research on leasing models.*** Proactive donor and stakeholder coordination is needed on legal and policy reform initiatives to ensure legislative and policy reform consistency across sectors. Scarce information exists on the demand and supply of leasing in rural areas and to agribusinesses. Further research and analysis on successful leasing models will help USAID missions and other donors understand how leasing can be integrated into rural finance and development projects and best reach rural and agricultural SMEs. Making existing studies by donors and leasing associations more widely available through better dissemination is also necessary.

***Advocate portfolio diversification as an effective risk mitigation tool for leasing companies to safeguard against defaults.*** Rather than exclusively target agricultural SMEs or rural areas, successful leasing institutions can better manage risk and portfolio quality by diversifying their client base geographically and by sector and size of leases. Default rates accounted for less than one percent of the leasing portfolio for several IFC assisted leasing companies interviewed. The low arrears and write-offs among SMEs may be attributed to the fact that productive equipment is too important to client operations to risk losing it by defaulting on lease payments.

***Assist in developing a strong leasing association.*** Strengthening the industry by supporting a sustainable national or regional leasing association that provides legislative advocacy and capacity building to leasing companies is an effective exit strategy for donors, if the industry is large enough to sustain such an association via member dues or other fee-based services. An association can evolve from a leasing advocacy working group as was the case of the North-West Leasing Association, which now functions an advocate on leasing policy and legislation as well as provides training services to industry players in northwestern Russia. Donor assistance in association building is a longer-term commitment since it may take more than five years for the association to become financially sustainable.



# ANNEX 1: BACKGROUND INFORMATION ON LEASING

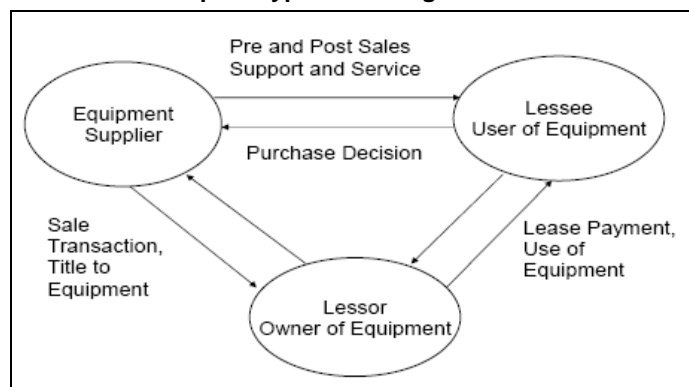
*“Leasing is a service industry whose main productive asset is people and brain power. The industry needs people who can think shrewdly and raise capital.”*

*- President of Europlan, Moscow-based leasing company*

## DEFINITION OF LEASING

Leasing is a method of financing the acquisition/use of fixed assets, predicated on the concept that the value of the asset is in its use in the business rather than through ownership. See specific definitions below under Mechanics. Leases are typically used to finance equipment, but can also be used for buildings and improvements (e.g., cold storage facilities) and are commonly used to finance vehicles. In this study asset, fixed asset, and equipment are used interchangeably.<sup>1</sup>

**Graph 1 Typical Leasing Structure**



<sup>1</sup> USAID, Rural and Agricultural Finance 4-Day Course CD Rom, (Washington: 2005).

A lease is a contract for the use of an asset for a set term of a year or more in exchange for fixed regular payments, between two parties. (See Graph 1 above).<sup>2</sup>

- The Lessor, which owns the asset
- The Lessee, which uses the asset

In the leasing industry, there are various types of lessors including private leasing companies, state-owned leasing companies; commercial banks and commercial bank subsidiaries; microfinance institutions, and equipment manufacturers. In a captive leasing model, a subsidiary leasing arm of a manufacturer or dealer is created for the main purpose of providing leasing to its parent company and/or dealer network.

#### **FINANCIAL VERSUS OPERATIONAL LEASE**

There are two types of leases, a financial lease and an operational lease. An operational lease is more comparable to a rental of equipment. Most leasing companies offer financial leases, an alternative form of finance to a bank term loan, and possess some characteristics that make it an easier type of finance to provide in an emerging market such as Russia.<sup>3</sup> (See Box 1 below).

#### **Box 1: Comparison of Financial versus Operational Lease<sup>4</sup>**

<b>Characteristics</b>	<b>Financial Lease</b>	<b>Operational Lease</b>
Term of lease	Most or all of useful life <sup>5</sup>	Less than economic life; may be multiple lessees
Required equity or security deposit	Moderate (15-25% in emerging markets, 1-4% in mature markets; less than loan down payment) <sup>6</sup>	Low
Residual value at end	Minimal	May be substantial
Transfer of ownership at end of lease	Yes, often for nominal payment	No
Recovery of cost + profit for lessor	Through stream of lease payments	Through stream of successive leases, and sale of asset at end
Responsibility for maintenance and insurance	Usually Lessee	Usually Lessor
Risk of damage, residual value	Usually Lessee	Usually Lessor
Cancellation option	Usually not available	Usually available

<sup>2</sup> USAID, Rural and Agricultural Finance 4-Day Course CD Rom.

<sup>3</sup> The term “leasing” usually refers to financial leasing in Russia.

<sup>4</sup> USAID, Rural and Agricultural Finance 4-Day Course CD Rom.

<sup>5</sup> Loans terms usually range from 3-5 years in Russia.

<sup>6</sup> In Russia, down payments range from 15-30 percent to both limit risk exposure and help finance leasing deals.

### GENERAL LEASING CONDITIONS AS COMPARED TO LOANS

Leasing offers some favorable conditions, as compared to bank term loans. Some of these advantages are highlighted below:

1. Leasing companies are usually not as *regulated* as commercial banks and face fewer restrictions regarding interest rates, credit allocations, and collateral requirements.
2. In leasing, *collateral* is usually only the equipment being leased, however lessors may require additional collateral.<sup>7</sup>
3. The *security position* of a lessor is stronger than a lender because the *title to the equipment* is in the hands of the lessor.
4. *Transaction costs*, including the processing time for leases are often lower than bank loans.
5. In case of default, *repossession* of the asset is easier because the lessor owns the equipment.
6. The *credit analysis process* is similar for both leases and loans, but the lessor has less risk because of the stronger ownership position.<sup>8</sup>
7. A *sale and leaseback* allows a lessee to purchase equipment from a supplier, sell it to the lessor, and then lease it back to increase cash flow.

However, in leasing, there is a *liability and litigation risk* and the lessor may have liability for third party losses from the operation of asset (especially vehicles).

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<sup>7</sup> Additional collateral is not usually required in Russia, but may depend on the deal.

<sup>8</sup> Repayment schedules can be flexible, usually monthly or quarterly, and a grace period may be permitted.

# ANNEX 2: INTERVIEW TOOLS

## INTERVIEW QUESTIONS FOR IFC/PROJECT LEVEL

### LEASING-GENERAL

1. What is the leasing market like in Russia? Rural leasing market? Agricultural leasing market? Market penetration? Value in terms of \$ and volume? Is there a used equipment leasing market?
2. What type of leasing is available—financial or operational?
3. Who are the key/strongest players—banks? Leasing companies? MFIs? Suppliers, etc?
4. What is competition like within the equipment leasing industry? How has it changed recently? How is it expected to change in the next few years?
5. What are the key sectors in ag leasing? In rural areas?
6. What are the main risks with these sectors in leasing? (Equipment valuation, maturity mismatch? Interest rate exposure? Term lending risk) Ag leasing? (weather risks)
7. What do you see as the key advantages of leasing over loans for developing agribusinesses and SMEs? Are there tax advantages?
8. When is the leasing the best option in Russia?

### IFC-GENERAL

1. Please describe IFC leasing activities in Russia?
2. How did IFC decide that leasing has a viable market?
3. Please describe the RLWG's main activities?

### ENABLING ENVIRONMENT FOR LEASING—LEGAL FRAMEWORK, REGULATION, ACCOUNTING, TAXATION

1. What is the current enabling environment for leasing in Russia?
2. What do you see as the strengths and weaknesses of the legal, regulatory, and policy environment for rural and agricultural leasing?
3. What has your project done to support the leasing environment, in terms of (tax) policies and the legal (clarify of leasing terms, repossession) and regulatory (prudential regulation/banks able to lease or through subsidiary) environment?

4. What policy, legislative and regulatory reforms were made? What activities/interventions led to these reforms?
5. What were the main obstacles and how were they overcome? What would you do differently next time?
6. Are lessors allowed to deduct depreciation from their taxable income? Is accelerated depreciation permitted? Are there advantages to leasing regarding VAT?
7. How are leased assets reflected in the accounts of the lessor and lessee?
8. Is insurance available/used in leasing?

#### **PUBLIC AWARENESS/EDUCATION ON LEASING**

1. What is the public's perception of leasing? Rural leasing? Ag leasing?
2. How did IFC generate public awareness about benefits of leasing? Who was involved? Was it effective? Is IFC involved in current activities related to public awareness?

#### **TECHNICAL ASSISTANCE TO LEASING COMPANIES**

1. How were the leasing companies established? What donor funding was leveraged?
2. Which leasing companies are the stars? Where do they operate? What products do they offer?
3. How has IFC strengthened local technical capacity in rural and agricultural leasing?
4. How did you assess demand for leasing among SMEs, especially in rural areas?
5. What role does IFC play as a technical assistance provider to AFC? As a shareholder of AFC?
6. What do you see as the costs/benefits of setting up a start up leasing companies? How much did IFC contribute to AFC?
7. What are advantages to this rather than providing technical assistance to existing companies?

#### **INTERVIEW QUESTIONS FOR LEASING COMPANY LEVEL**

##### **GENERAL BACKGROUND**

1. When was the leasing operation established?
2. Who established it?
3. Who owns it now? What is your company's governance structure? Do you have a board of directors? What is their role?
4. Where is the company headquarters based and operate?
5. What is your organizational structure?

##### **LEASING PRODUCTS**

6. What types of leasing products are offered for rural markets?
7. What criteria are used for client selection?
8. What is the processing time, appraisal/approval process, mode of disbursement, collection process, payment incentives and repossession process?
9. How are leases approved?

10. What is the volume in number and USD value of leasing in the last three years?

#### **LEASING MARKET**

11. How many clients do you have? Who are the clients?
12. What sectors/subsectors are you willing to work with?
13. What are your estimates of client demand? How did you develop these estimates?
14. How do you identify new clients? Are there other clients you haven't been able to reach? Why/why not?
15. How do you assess client satisfaction with the leasing product?
16. In which sub-sectors is there demand for your leasing product(s)?

#### **CHALLENGES**

17. What are the major challenges you've faced with regard to legal or regulatory constraints? How were they overcome?
18. Who is the competition for equipment leasing? How do their products/services compare? Do you compete with supplier finance arrangements?
19. What is your competitive advantage?
20. Have any leasing services not been successful? Why?

#### **NON-FINANCIAL SUPPORT**

21. What non-financial support infrastructure is available to you?
22. Are you a member of a business association? If so, which one? What services are provided? What is your opinion of the services?

#### **FUTURE PLANS**

23. What are your future plans for product development and expansion? What is growth path?

#### **FINANCIAL MANAGEMENT**

24. How do you price of products? Are you interest rates market rates? Can you cover your costs?
25. What technical assistance do you provide lessees, if any? What is the cost of this and who pays?
26. What information do you capture on your management information system? How is this information used? How do you measure client retention?
27. How do you manage portfolio risk?
28. Is your company profitable? If not, when do they expect to be? What steps are you taking to become profitable? What financial sources were/are being used to fund leasing activities? Are you using donor funding?

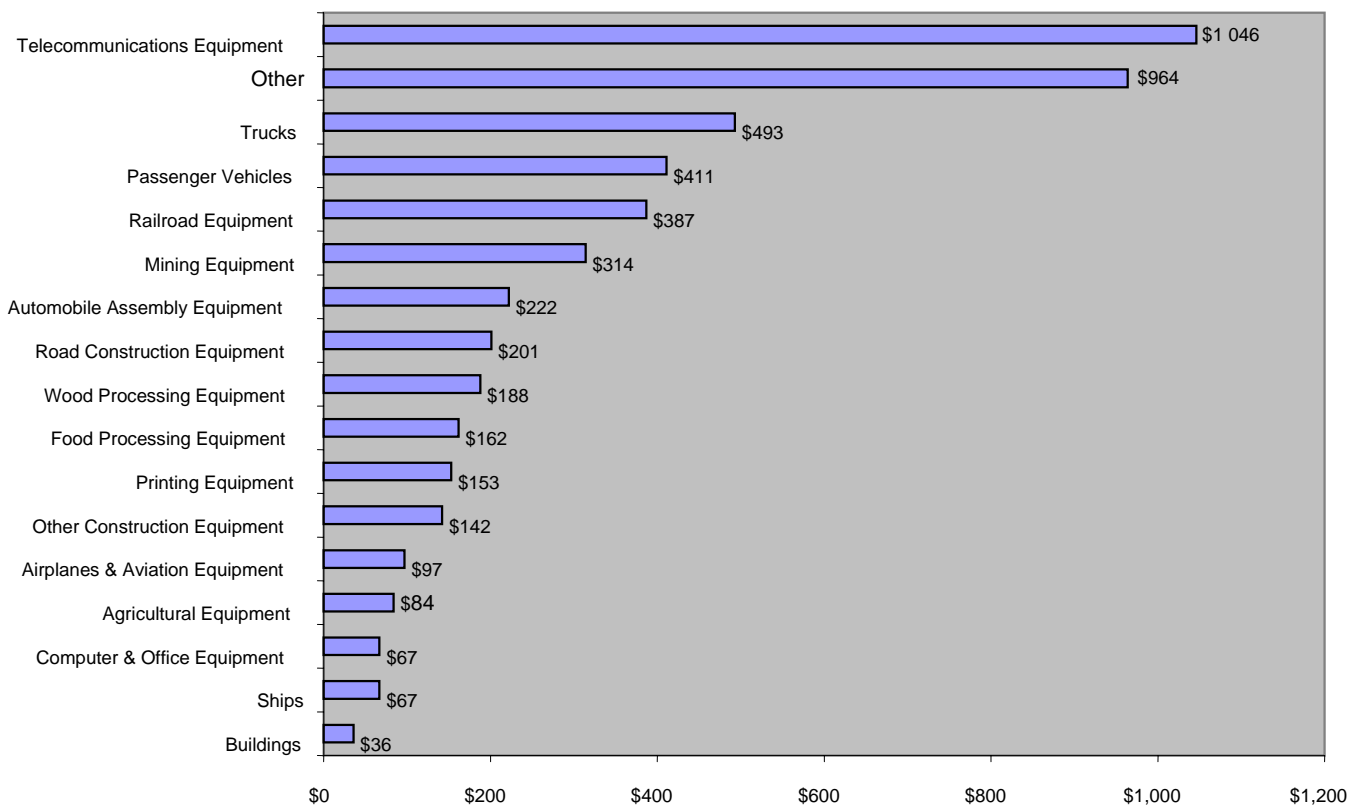
#### **INTERVIEW QUESTIONS FOR CLIENT (LESSEE) LEVEL**

1. What is the nature of your business? Sector? Size? Location? Volume?
2. What financing options are available to you?
3. What type of lease do you currently have?
4. Why did you engage in this leasing arrangement?

5. What did you perceive as the benefits to leasing?
6. If you could change something about the leasing arrangement, what would that be?
7. How has your business changed/improved as a result of leasing arrangement? What changes have you observed in production, processing, efficiency, revenue, etc.
8. Has the leasing company ever asked for your feedback on the product? If so, how?
9. What technical assistance does the leasing company provide?
10. Has this been beneficial to your company?
11. What are your plans for your company for the next 3-5 years?
12. Why is leasing the best financial option for your business?

# ANNEX 3: 2004 LEASING SECTOR SURVEY RESULTS

**2004 LEASING VOLUME BY SECTOR (IN MILLIONS OF USD)**



Source: Expert Magazine, Russian Leasing Market in 2004



# ANNEX 4: LIST OF PERSONS INTERVIEWED

**1. International Finance Corporation (IFC)/Moscow:** Randal Petersen, Senior Operations Manager, Financial Markets; Andrei Joosten, Project Manager, Russia Agribusiness Project; Elena Markova, Team Leader, Agri Leasing Promotion Project; Yana Gorbatenko, Operations Analyst

**2. International Finance Corporation (IFC)/Leasing Development Group/North-West Russia Project/St. Petersburg:** Igor Gruzdev, Team Leader; Irina Reshetnik, Deputy Team Leader; Andrey Rummyantsev, Financial Analyst

**3. USAID/Russia:** Thomas Martens, Deputy Director, Office of Regional Development

**4. Agro-Industrial Finance Company (AFC):** Sergey Ulianov, General Director; Olga Klyachko, Relationship Manager; Nina Larina, Head of Risk Management Department

**5. Rabobank International:** Maarten Pronk – AFC Chairman of the Board and Country Manager

**6. Kolkhoz Rodina (AFC client):** Alexander Samoshkin, Director

**7. KubanAgroProd (AFC client):** Evgeny Kabanov, General Director; Alexander Zoob, Director

**8. Europlan:** Nikolai Zinoviev, President; Victoria Khablyuk, Director, Krasnodar Branch; Leasing officer, Krasnodar Branch; Deputy Director, Premix (Europlan client)

**9. Center-invest Bank:** Anna Shtabnova, Chairman of the Board; Alexander Betz, Head of Agribusiness Credit Department

**10. Kubanleasing:** Natalya Popova, Head of Finance Department

**11. Lovells Legal Services:** Timofei Kotenev, Consultant

**12. American Chamber of Commerce Leasing Committee:** Mikhail Kiselev, Co-chair of Leasing Committee

**13. Raiffeisen Leasing:** Sergei Kileinikov, Director of Sales and Business Development

**14. Ernst and Young:** Fred Strickland, Consultant

**15. North-West Leasing Association:** Tatiana Pozdnyakova, Director; Marina Yurina, Deputy Director

**16. CJSC Baltic Leasing:** Dmitry Korchagov, CEO; Vladimir Naimark, Commercial Director; Zuchra Redkovich, Director of Leasing Development

**17. Universal Leasing Company:** Irina Akmen, Project Manager

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