



microNOTE

Coping with the “Unexpected”— The Experience of ACBA Leasing in Armenia

The experience of the start-up and growth of the ACBA Leasing Company is a good example of how elements at all levels of development must be addressed for a successful outcome in establishing leasing to support agriculture and agribusiness.

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INTRODUCTION

Leasing is a useful financing mechanism for the acquisition of equipment and vehicles for agricultural and agribusiness use. Financial leases are term finance, typically for two- to five-year periods, and the equipment acquired through the lease is also the collateral for the lease. These characteristics, along with lower downpayments, mean that financial leases are a viable alternative form of credit in countries where banks require substantial collateral for loans and may not have the funding structure to offer term loans.

The benefits and limitations of financial leasing have been well documented elsewhere.¹ This *microNote* discusses some of the challenges that might be encountered in trying to establish a leasing company. The experience of the start-up and growth of the ACBA Leasing Company is a good example of how elements at all levels of development—the micro or firm/financial institution level; the meso or enabling institution level; and the macro or legal and regulatory environment level—must be addressed for a successful outcome in establishing leasing to support agriculture and agribusiness.

USAID's Agribusiness Small and Medium-Sized Enterprise Market Development Program (ASME) in Armenia supported the

¹ See Nair, Ajai, Renate Kloeppinger-Todd, and Annabel Mulder. *Leasing – An Underutilized Tool in Rural Finance*. Agriculture and Rural Development Discussion Paper 7, The World Bank, Washington D.C., 2004.

creation of the ACBA Leasing Company out of necessity: program clients needed a source of term financing for equipment, and the local banks were only providing loans for terms of a year or less. ACBA Leasing was started in 2003 with USAID support and technical assistance to provide better access to effective term financing for agribusinesses and small and medium-sized enterprises, especially in rural areas where collateral requirements are tougher to meet.

Leasing in the Regions

ACBA Leasing focuses on leasing in the regions and has the greatest number of leases there. However, individual lease amounts to agriculture average about \$5,000, much smaller than industry leases of \$35,000 or service sector leases of \$33,000.

START-UP HURDLES

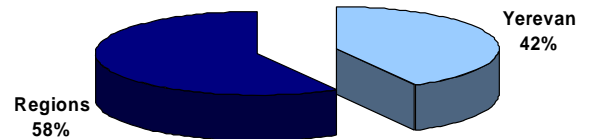
The first step in establishing the leasing company was to commission a good market study. The study concluded that there was potential in several productive sectors, but that the agriculture and agribusiness sectors in the country were not large enough to support a leasing company by themselves. The founding shareholders—ACBA Bank, Crédit Agricole of France, the Lebanese Leasing Company, and the International Finance Corporation (IFC), drew up the company charter to emphasize the interest of the

leasing company in supporting these sectors, as well as a focus on financing productive equipment rather than consumer automobiles.

The shareholders also insisted that start-up could not occur without modifications and improvements to the Civil Code, which were supported jointly by ACBA, IFC, and USAID and were adopted by the Armenian Parliament and signed by the President of the Republic in 2002. In 2003, the law on Non-Bank Financial Institutions, which specified how leasing companies are governed, was adopted. This law also specified that the Central Bank of Armenia is the regulator for leasing companies.

In addition, USAID supported the State Cadastral Committee in creating a movable property or collateral register. Registration is proof of property ownership, and the registration system requires that there be a check of the registrar upon second-hand sale to confirm that the

By Number of Lease Contracts



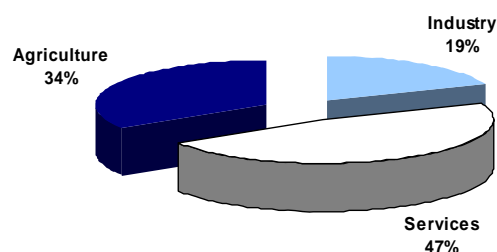
property being sold is exempt from legal constraints such as pledges or leases. A good collateral registry records all liens or encumbrances on property, including bank loans, leases, and contingent sales, whether or not the property is owned by the possessor.

THE “UNEXPECTED” PROBLEMS

ACBA Leasing has been growing strongly since its start-up, and as of June 2006 had signed 218 leases for 674 pieces of equipment valued at \$5.6 million. The company has encountered three types of problems that it did not expect at the outset: difficulties with distributors/importers; a lack of understanding of leasing in the country; and other legal, regulatory, and policy issues.

In all cases ACBA Leasing has had to be imaginative and innovative in addressing these problems, and has even been able to turn them to its advantage.

Number of Leases



Distributors and Importers

In many cases, the equipment being leased is being imported into Armenia for the first time, so ACBA Leasing and the distributor are breaking new ground. In addition to a loan analysis, ACBA Leasing also includes an **equipment analysis** as part of its lease analysis, which focuses on:

- Availability;
- Life of the equipment;
- Local capacity to maintain and service the equipment; and
- Resale value.

Many of these considerations are dependent upon the **qualifications of the local importer or distributor of the equipment**; the stronger the importer/distributor, the less risky the transaction. Of course, the more that particular types of equipment are imported, the better the understanding of manufacturing and shipping problems and, hence, lessened risk. ACBA Leasing has established an asset manager position to analyze the equipment being leased and to maintain good relations with the distributors. An added benefit of these close relations with the distributors is price discounts: for instance, ACBA Leasing gets a 5 percent discount on the purchase of both Kamaz Trucks (Russia) and Heidelberg printing

equipment (Germany). This discount is passed on to the lessee. The lessee/customer also benefits from ACBA Leasing's experience in dealing with the distributors and with importation procedures. ACBA Leasing currently deals with 28 foreign suppliers and 33 Armenian distributors.

Lack of Knowledge of Leasing

The need for public education on leasing was certainly expected, but in a country that had never had a commercial leasing operation before, the need was particularly acute. Education about leasing was needed for staff, clients, and government.

- Providing training for credit officers of ACBA branches;
- Conducting workshop sessions targeted to branch managers;
- Assigning a credit officer in each branch to coordinate leasing activity;
- Sending regular information notices on leasing to branch managers and credit staff; and
- Paying commissions to each branch for every lease deal; the commissions are shared between the branch and the credit officer/leasing coordinator.

The ChinVan Case

ACBA Leasing has even supported the creation of Armenian distributors and dealers. The ChinVan Company, located near Vanadzor, began importing and assembling small tractors and implements from China for lease to farmers in the Lori region, in the northern part of Armenia, financed by ACBA Leasing. ChinVan and ACBA Leasing jointly sponsored tractor demonstrations for village associations and farmers, and ChinVan provided after-sales service and maintenance. Soon after start-up, ChinVan started manufacturing some of the parts and attachments locally. In the near future, ChinVan will only import the engine and a few mechanical parts, and will manufacture all other components in Vanadzor.

For the ACBA Bank itself, the education problem was exacerbated by the fact that ACBA Leasing staff are only located in Yerevan, and the ACBA Bank branch staff were not selling the product in the regions as expected. ACBA Leasing took several steps to address this:

For education of potential clients and industry partners, ACBA Leasing takes all opportunities to:

- Hold presentations at industry seminars and workshops;
- Participate in agribusiness industry sessions sponsored by donors; and

- Develop and provide training materials to potential suppliers, distributors, and importers.

Government officials have also been invited to the industry seminars, but the more effective approach has been education on a one-on-one basis with policy makers.

Law and Policy Issues

Although ACBA Leasing did ensure that minimum legal and regulatory provisions were in place prior to start-up, certain issues could not be fully anticipated or required attention as they occurred. Fiscal regime concerns are the most obvious of these problems. Before 2005, there was a special list of equipment that was exempt from value-added tax (VAT) when imported for use, but which was subject to VAT if imported for lease. Another problem at that time was that the interest portion of lease payments was also subject to VAT. This effectively amounted to a double taxation of sorts, because VAT was already included in the lease amount; thus, VAT was being charged on the interest being paid on a VAT amount.

As the result of education and advocacy efforts by ACBA Leasing among policy makers, these problems have been resolved. The equipment in the exemption list is imported and leased

without VAT, and interest portion of lease is VAT-exempt.

Other problems have been addressed by development of leasing company policies as necessary. For instance, the customs office and other government bodies generally could not understand that one entity would own a piece of equipment but another would possess it and use it. To deal with this, ACBA Leasing instituted a policy of giving its lessees a power of attorney to use the equipment, so that the lessees can deal with government and other offices as necessary.

Finally, one-off issues arise that must be dealt with on the spot and may lead to initiatives for additional legal or regulatory changes. A good example of this arose recently when the government issued requests for proposals to supply minibuses for transportation for the regular bus routes in Yerevan. The terms of reference noted that two-thirds of the vehicles that would be used had to be owned by the contractor-operator, which suggests an effort to ensure that the contractor-operator was large and substantial enough to take on the job and was not just a patching together of single vehicle owner-operators who could not be controlled well. These terms, while reasonable and understandable, did not contemplate that the vehicles

might be financed through leases rather than through bank term loans or equity. Although leased vehicles would be fully under the control of the operator, as much so as if the vehicles were titled to the operator (although pledged as collateral for bank loans), the terms of reference did not reflect this. ACBA Leasing is dealing with omissions and gaps such as these that cannot be predicted, but which are only likely to subside as leasing becomes more accepted.

Arman Hakobyan is the finance specialist with USAID's Armenia Agribusiness Small and Medium Enterprise Market Development Program, implemented by DAI. This microNote is based on a presentation given at the USAID Broadening Access and Strengthening Input Market Systems (BASIS) Rural and Agricultural Finance Workshop held in Kyiv, Ukraine, in July 2006.

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