

The Constraints of Leasing in Algeria: The Case of SOFINANCE (Joint Stock Company)

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Received: 20-09-2019

Accepted: 30-09-2019

Published: 30-09-2019

Abstract:

Algeria seeks to develop small and medium enterprises to reduce its dependence on hydrocarbons revenue. But the funding problem drags down SME success at all steps. One of the reliable funding solutions is Leasing as it seems to be an investment financing solution and offers many advantages. However, we cannot ignore the fact that no miracle solution exists, and that like all things leasing also has its fair part of obstacles, which is the main subject of this article, that aims to identify the source of the obstacles restraining the development of the leasing among Algerian SMEs.

Keywords: Leasing, SMEs, Financing, Obstacles, Algeria.

JEL Classification: G2, G20, G24.

ملخص:

تسعى الجزائر لتطوير المؤسسات الصغيرة والمتوسطة للحد من اعتمادها على عائدات المحروقات، لكن مشكل التمويل يعيق نجاحها على كل المراحل. يعتبر التأجير من بين الحلول التمويلية المعتمدة إذ يمثل حلا ماليا استثماريا ويوفر العديد من المزايا ومع ذلك، لا يمكننا أن نتجاهل حقيقة أنه لا يوجد حل معجزة، وأنه مثل كل شيء، التأجير أيضا له نصيبه العادل من العقبات، والذي هو الموضوع الرئيسي لهذا المقال، والهدف هو تحديد مصدر العقبات التي تقيد تطور التأجير لدى المؤسسات الصغيرة والمتوسطة الجزائرية.

الكلمات المفتاحية: التأجير، الشركات الصغيرة والمتوسطة، التمويل، العقبات، الجزائر.

تصنيف JEL : G2, G20, G24

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1. Introduction:

Small and medium enterprises are seen as the engine of the development of an entire nation, fuel that boosts the country's economic sphere. According to P. To Julien and Marchesney «Small enterprise is at the heart of the transformation of our economies...» (Julien & Marchesney, 1988, p. 56) In this context, the Algerian state has thought of setting up organisations, structures and reforms, going in the direction of encouraging the creation of enterprises and developing through the various structures of support and aid to SME (Andi, Ansej), even going as far as tax exemption and various subsidies.

However, the Algerian SME, like its fellows around the world, suffers from a major problem that greatly holds down its development: this is the problem of financing. Indeed, according to a survey conducted by the World Bank in 2001 on the size of companies and their environment, (Schiffer & Weder, 2001, p. 16) the subject of business constraints were addressed and the financing problem is at the top of the rankings, unanimity, and on a global scale. According to the results of the survey, financing would be the number one obstacle facing SMEs, and would also be the main cause of their mortality, followed by the country's fiscal policy, inflation, corruption, judicial system etc. Nearly twenty years after this survey, the financing problem persists, especially in Algeria, despite all the structures made available to entrepreneurs.

In general, any company of all sizes has the choice of financing itself in two distinct ways; it may opt for internal funding or external funding. Among the financing methods, leasing; which is considered as a real financing solution for the SME and especially in Algeria, given the many advantages that give it. However, this last statement leads us to raise certain points; as long as leasing is considered an investment financing solution for SMEs, why is the use of Leasing not so widespread in Algeria? More explicitly what is holding back the development of leasing in Algeria, especially among Algerian SMEs? it cannot be ignored that the company must have its part of obstacles and difficulties in its application that the company must face; this is why the main topic of our work will be the nature of the obstacles faced by the Algerian SME during leasing financing.

The methodological approach used is arranged as follows: The basic definitions and notions for SME and its financing in general; then the leasing from its history to its current form, its characteristics, and its relationship with the SME. Finally, we will strive to answer the problem, highlighted by our research and experience with the company SOFINANCE (Joint Stock Company).

2. Generality on SME:

2.1. Definition:

The term SME refers to an acronym meaning small and medium enterprises, which are defined by the number of employees, the balance sheet or the turnover. The main criterion used is the number of employees. SMEs are considered to be companies with between 20 and 249 employees. Below 20 employees, we will talk about VSE (very small

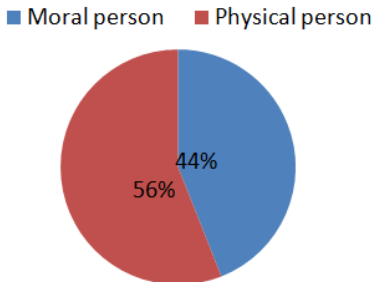
enterprises). With more than 249 employees and up to 4999, we will talk about ISE: Intermediate size enterprise. According to the French institute INSEE "The category of small and medium enterprises (SME) consists of companies with fewer than 250 employees, with an annual turnover of fewer than 50 million euros."(INSEE, 2016)

SME are, according to the European Commission's (EC.Europa) definition, companies with fewer than 250 people. In addition, there are two other criteria to choose from: annual turnover must not exceed 50 million euros, or the total balance sheet must not exceed 43 million euros (Commission recommendation of 6 May 2003).

In the Algerian context, the SME is a company producing goods and/or services employing one (1) to 250 people and whose annual turnover does not exceed 4 billion dinars or whose total annual balance sheet does not exceed 1 billion DA.

The number of SMEs has increased significantly over the past few years, according to statistics collected by the official newsletter of the Ministry of Industry and Mines for the first half of 2017, the results are quite satisfactory. Indeed, it has been reported that at the end of the first half of 2017, the overall population of SME stands at 1060289 entities, of which almost 57% are incorporated, of which there are 264 Public Economic Enterprises (EPE). The rest are made up of individuals (44%), 21% of whom are professionals and 23% are crafts.

Fig1: A Diagram illustrating the components of the SME in Algeria.



Source: A diagram by the authors of this article, using data collected by the Ministry of Industry and Mines.

2.2. SME breakdown by industry:

Algerian SMEs operate in five main sectors: agriculture, hydrocarbons, energy mines and related services, buildings public and hydraulic works, manufacturing and finally the services sector. The following table recounts the numbers of the SME statistics bulletin collected for the year 2017 concerning the sectors of SME activity in Algeria and their distributions as a percentage.

Table 1: Breakdown of SMEs by industry and percentages for the first half of 2017.

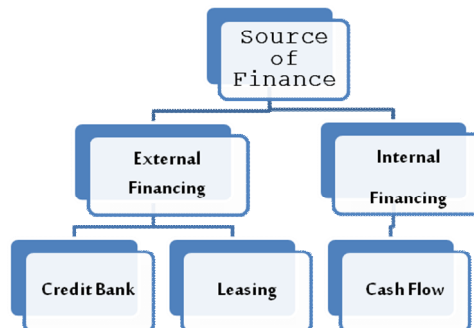
Sector	1 st half 2017	Percentage
Agriculture	6392	1.07%
Hydrocarbons, energy mines and related services	2843	0.48%
BPHW	177727	29.83%
Manufacturing	92804	15.58%
Services	316044	53.04%
Total	595810	100%

Source: Table produced by the authors of this article, using data collected by the Ministry of Industry and Mines.

Analysis of the figures from the distribution table of the sectors where SMEs operate in the first half of 2017 shows a strong concentration on services activities, which represent 53.04% of all enterprises followed by the BPHW sector. 29.83% and the industry by 15.58%.

The use of financing in any form is a necessity for the company's activity, in order to achieve its objectives, it benefits from several sources of financing all adapted depending on the nature of the need for financing that it is on the short-term, medium-term, or long-term. The company has the choice to self-finance through the non-distribution of its profits, or the sale of its assets, just as it can turn to an external financing method which may be direct, via issuance in the financial markets, or indirect, requiring some form of intermediation, between the company and the capital-raising companies. By a credit in exchange for interest, the task remains to determine what type of credit is best suited to meet the financing needs of the company, whether they are from the investment cycle or the operating cycle. The company also has the choice to turn to leasing as a means of financing its investments which is the main topic of this article, we will develop deeper in the following pages

Fig2: Company funding sources



Source: by the authors.

3. General on leasing:

3.1. History of Leasing:

Leasing is an Anglicism describing a transaction allowing the acquisition of property in exchange for royalties and the option of a property right at maturity. Born in the United States in the 1950s, "leasing" was introduced in Europe and especially in France only in the 1960s under the name of leasing. However this operation will not be the most recent, it would be just as old as the era of trading and exchange, renting property is an ancestral practice.

3.1.1. Leasing in the age of ancient civilizations:

According to historians and economists, leasing goes back much longer in history, in fact, it was possible to trace transactions similar to the leasing dating from the Sumerian era or 2000 years before Jesus Christ, this was even found written on clay tablets found in the ancient Sumerian city of Ur, containing information on the rental of agricultural equipment, land, irrigation systems, cattle and other animals. The great philosopher Aristotle also refers to the idea of leasing, arguing that true wealth lies in the fact of use, not in property. Other evidence of the existence of a principle similar to leasing could be reported from the Roman era as well as evidence written in the code of Hammurabi, dating from 1760 BC. Many other ancient civilizations have used this type of financing tools, such as the Greek, Egyptian, and even Phoenician civilizations. According to the manuscripts and papyrus found, leasing was the only affordable way to procure and finance equipment, land, animals, and even boats including the crew as a bonus. During the medieval era, in addition to the rented production and agricultural equipment, weapons of war and armadas were added.

With the industrial revolution the development of metallurgy and the textile industry, the intense mining activity and the considerable growth of transport and the invention and start-up of the steam engine thus creating new opportunities for expansion for the leasing market which experienced first a meteoric rise in the United States, Canada and subsequently Europe.

3.1.2. Development of leasing worldwide:

As it has been mentioned previously, historically leasing is not a recent practice, but goes back to antiquity, it is only during the last fifty years that it has experienced a development of its principle and the form that we know about him right now.

The United States presumed to be the birth country of the current leasing, is also considered to be Globally, largely the first market with a significant propensity for leasing in investments, in the order of 30%, a figure that Europe only reaches at half currently. (Gervais, 2004, p. 11)

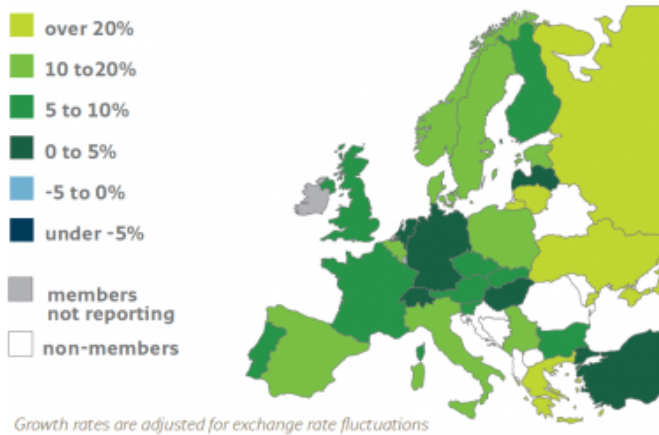
According to the European leasing federation, the European leasing federation is a very widespread method of financing in all four corners of Europe and is experiencing a real boom, in France in particular, this tool was introduced there in 1962, then formalized in

1966, it has known since then a very quick development. (Nicolas & Trogan, 1970, pp. 33-42)

The federation is responsible for writing annual reports on the leasing market based on the figures and statistics collected from its 47 member countries. The reports are then classified as dissected and schemed in the form of graphs and figures. Here are the figures reported by the federation for 2016:

Fig 3: Leasing expansion volume in Europe in 2016

New Leasing growth rates by country in 2016



Source: (www.leaseurope.org)

We notice on the map that leasing financing is expanding in Eastern European countries with a 20% increase in the volume of investment acquired in this way. According to reports from the Leaseurope federation in 2016, 49% of the investments acquired by leasing in Europe were passenger vehicles, compared to 28% of all types of equipment, the percentage of commercial vehicles is 18% in real estate, they represent only 5%.

3.2. Descriptive leasing study:

This section will focus on the exact definition of leasing, how the transaction is going and how it works.

3.2.1. Definition of Leasing:

By definition, Leasing is a contract by which a person, the lender credit (financing company, bank...) Buys a property and makes it available to another person, the lessee, for the payment of rent. The lessee is therefore not legally the owner of the property made available to him.

According to INSEE Leasing is a financial transaction that allows you to acquire a property through a monthly lump sum payment called a royalty and to claim an option to purchase at the end of the lease agreement. (INSEE, definition)

3.2.2. How does a leasing operation work?

People wishing to finance their investments by leasing must, after determining the property to be acquired and have reached an agreement with the seller, approach a leasing company

(or banks, financial institution). After a review of the financial situation of the person concerned and the agreement on the financed property between the lessor and lessee, the file is accepted by the leasing company. A lease agreement is then signed between the leasing company and the company, with a promise to sell at an agreed price. The rental starts at the reception of the equipment.

- **Terms of contract**

By this contract, the owner transfers the right to use the property against the payment of rent for a fixed period, after which the lessee has three options:

Lift the option to purchase by acquiring the property at a rate that takes into account payments already made.

Return the property to the lessor.

Extend the rental period.

When signing a leasing agreement, each of the two parties, the lessor and the lessee must meet obligations

- **End of contract :**

At the end of the contract, the lessee has the choice between three options:

- The option to purchase: the lessee acquires the property at the agreed price at the signing of the contract. More often than not, the price paid is reduced from the security deposit paid at the signing.
- Restitution of the property: the security deposit is then refunded to it.
- Signing a new lease agreement for the same property but, usually with royalties lower than the previous ones or for a new property.

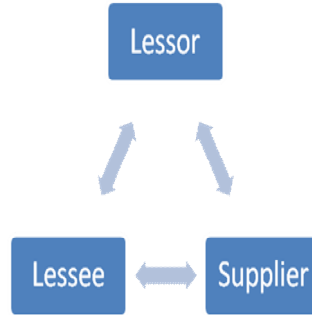
- **lessor's obligations**

- Yielding property in good condition.
- Receive payments.

- **Lessee's obligations**

- Make payments.
- Choose whether or not to acquire ownership of the asset at the end of the contract.

The operation, therefore, involves three players: the user (lessee), the lessor (renter financing the investment) and the supplier of the asset.

Fig 4: The triangular relationship between the three parties

Source: by the authors.

For SMEs, leasing presents itself as an interesting opportunity to acquire the material properties necessary for the production of goods and services. Investments in real estate and furniture may be too large for small and medium enterprises. The capital contribution may be too high relative to the available capital or it may force the company to forego other projects. Leasing then allows the company to keep capital intact, allowing it to take out other credit just as necessary for its development without adding to its debt. It is a flexible solution because it can adjust to the needs of the company. For example, for a small business that is starting with little acquired capital, it may be more convenient to rent a specific machine or tooling rather than buy it. With this service, the company's budget for the acquisition of personal property and real estate is established until the end of the lease. Thus, this investment is perfectly controlled since the amount of invoices is known for the duration of the contract.

The leasing market in Algeria is considered relatively new and has only really developed in recent years, it has a total of twelve entities offering this method of financing, divided into two main categories, on the one hand, the companies specialized in leasing, on the other the banks or financial institution with a department offering leasing. Among the financial institutions offering leasing, Sofinance (Joint Stock Company), placement, participation and Investment Finance Corporation, is a public financial institution approved by the Bank of Algeria on January 09, 2001, with a share capital of 5, 000, 000,000 DA. In 2017 its social capital rose to 10, 000, 000,000 DA.

SOFINANCE JSC was created on the initiative of the National Council of State Participations (CNPE) with the main tasks of support in the modernization of the national production tool and the development of new financial products. Its social purpose includes all occupations developed by the universal bank excluding customer deposits and the management of means of payment.

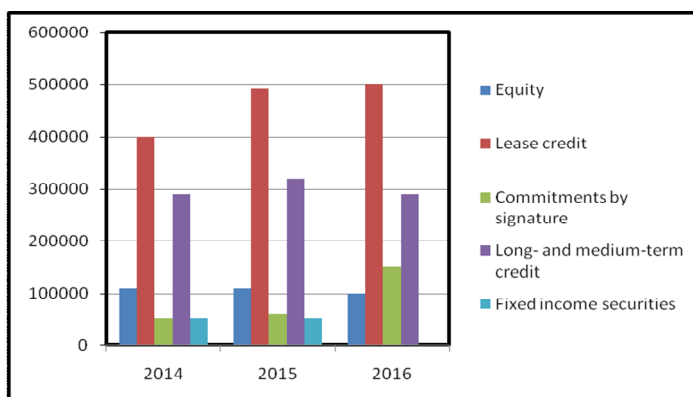
4. The SOFINANCE (JSC) in numbers:

Table 2: Sofinance review from 2014 to 2016in KDA

	2014	2015	2016
Social capital	5.000.000	5.000.000	5.000.000
Clean background	7 866 000	8 265 000	8 639 000
Total balance sheet	9 974 124	9 974 124	12 029 000

Source: www.sofinance.dz, accessed on 20/04/18.

Fig 5: Sofinance commitments over the past three years.



Source: (www.sofinance.dz) accessed on 20/04/18.

There was a clear increase in equity with stable share capital during the three years from 2014 to 2016, resulting in an increase in the total balance sheet from 9,974,000 DA in 2014 to 12,029,000 DA in 2016. Noted that the social capital rose to 10,000,000,000 in 2017.

According to the figures published on the official website of Sofinance, we note stability in fixed income securities, and fluctuations in equity holdings and long- and medium-term loans. We also note an increase in leasing activity as well as signature commitments over the three years from 2014 to 2016.

Sofinance JSC's obstacles to the application of leasing:

It was found that at the application of leasing, the SME of all its nature of activity (BPHW, production, industry or services) faced a number of obstacles and problems, relatively embarrassing or even disabling, delaying the operation, until the SME's absorption of the problem, or in some cases the SME was even categorically denied the request for funding. These barriers can take different forms, whether at the time of the file being set up, which may even extend to the payment of royalties. Among these obstacles are the most

relevant: As the file is set up, Sofinance requires a technical and economic study of the company wishing to finance itself, as well as a forecast balance sheet for the next five years.

However, even if the figures provided by that company are very optimistic, this is not a criterion for granting leasing, other criteria are much more taken into account and in particular the seniority of the company; which must be at least two years of age or older in order to qualify for a leasing-type credit. The company must also be irreproachable towards tax and social security agencies. Another condition and not the least; the company must in no way be reported to the risk centre, if this is the case, the company's application will be systematically refused. Sofinance is perceived to be quite flexible in terms of payment, as the company has the choice to pay quarterly or bi-monthly, however, the company may run out of liquidity and funds unable to meet its debts. Companies in direct contact with state-owned enterprises, also suffer from the payment constraint operating by the rate of progress situations thereby delaying the payment of the due amount, once the deadlines are overpassed, Sofinance has no choice but to send notices and clamp down consequently.

5. Conclusion:

There is no doubt that Algeria, through its efforts, seeks to increase the development of the SME, and the local production in order to gradually free itself from the influence of hydrocarbons on its overall income. However, despite all that has been committed, the Algerian SME is still far from having reached the desired level, and Algeria still suffers as much from its dependence on hydrocarbons. What is most delaying this development of SMEs is not the lack of ideas in itself but above all the lack of funds. This financing problem that it faces can be solved in theory through the use of third parties outside the company, the issuance in the financial markets of bank loans, leasing.

Leasing is thus one of the investment financing solutions used by the company, however, we have been able to see that the company also had its share of obstacles hindering its proper deployment in the world of SMEs.

Thanks to our experience in Sofinance, we have seen that these so-called obstacles can come from the financial institution proposing leasing, for example, given the bureaucratic heaviness faced by the concerned company. to acquire an investment in that way. These constraints can take the form of a multitude of legal documents to be presented as well as a good number of guarantees to support the funding application.

The company, on the other hand, may find itself ineligible for such a method of financing, if it does not present certain irreproachability in all respects at the risk of displeasing its potential borrower and therefore its application will be denied.

The institution offering leasing may be less accommodating, and insensitive, in front of the various difficulties that the company that has acquired an investment in this way may encounter, especially if it struggles to meet its due amounts. It may find herself cornered, in addition to that, by late penalties pushing her further to the brink of the abyss even in some

cases until the seizure of her property, despite convincing proof of late payment. The institution offering leasing cannot wait indefinitely for its payment.

What we can recommend, would certainly be to lighten the procedures for applying for leasing, by giving more importance to the purpose of financing the project itself and the impact of its creation in the Algerian economy, rather than to the administrative solidity of its case.

In addition, state intervention in the form of an Advisory and Management Agency for SMEs would be of great help, especially to start-up entrepreneurs, in order to ensure better management of their resources and therefore a repayment on time regarding the loan given.

In conclusion, indeed, the implementation of leasing in Algeria dates back to almost twenty years, however, it is still in its infancy and its potential has not been fully exploited. A lot of entrepreneurs use it only by chance, via the internet, or by word of mouth, without measuring all the advantages that it presents, the state will seek to promote it increasing its popularity by informing young entrepreneurs because it will certainly help with its deployment and success with the Algerian SME.

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How to cite this article by the APA method:

Elagag, M., & Berrefas, I. (2019). The Constraints of Leasing in Algeria: the Case of SOFINANCE (Joint Stock Company). *Management & Economics Research Journal*, 1(3), 27-37. <https://doi.org/10.48100/merj.v1i3.40>

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