FINANCIAL LEASING IN MENA REGION: AN ANALYSIS OF FINANCIAL, LEGAL AND INSTITUTIONAL ASPECTS

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* Views expressed in this paper are those of the author and should not be necessarily attributed to any other organization the author is affiliated to.

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Abstract

This paper assesses the financial leasing industry and its role in enhancing financial intermediation in various MENA countries. The approach followed involves critical and comparative analyses of financial indicators, as well as review of legal, regulatory, and institutional frameworks in the selected countries. The paper identifies impediments, and sets out various policy recommendations on promoting the role of the financial leasing sector in deepening financial systems, and enhancing enterprises access to finance, especially small-scale ones. It is evident that various countries in MENA have made major strides in recent years towards developing financial leasing, however various challenges still remain ahead.

ملخص

تقوم هذه الورقة بتقييم قطاع التمويل الإيجاري ودوره في تشجيع الوساطة المالية في العديد من دول الشرق الأوسط وشمال أفريقيا. ويتضمن المنهج المتبع تحليل نقدي مقارن للمؤشرات المالية، بالإضافة إلى استعراض الهياكل القانونية، والتنظيمية، والمؤسسية في الدول المنتقاة. وتقوم الورقة بتحديد العوائق، وتقدم توصيات متعددة للسياسة حول تعزيز دور قطاع التمويل الإيجاري في تعميق النظم المالية، ودعم وصول المؤسسات للتمويل، خاصة المؤسسات الصغيرة. ومن الواضح أن دول عديدة في الشرق الأوسط وشمال أفريقيا قد قطعت أشواطاً كبيرة في السنوات الأخيرة نحو تنمية التمويل الإيجاري، وبالرغم من ذلك فلازال أمامها بعض التحديات.

1. Introduction

A well developed, diversified, and efficient financial system can spread risk and provide a sound base for sustainable economic development. Financial intermediaries play a key role in providing funds to entrepreneurs, which is crucial for economic growth. Developing financial intermediation can lead to an increase in real growth rates. There is growing literature that supports a positive relationship between financial sector functions and structure, and economic growth.[1] On the empirical side, a range of financial indicators were found to be strongly positively correlated with economic growth. Among the empirical studies, King and Levine (1993) came up with strong evidence that economies with a well developed financial system grows faster than similar economies lacking one. Other studies show that countries characterized by financial deepening, tend to enjoy faster growth.[2] Development literature has also indicated that countries characterized with a diversified financial system, and a developed non-bank financial institutions are more resilient to economic shocks. However, financial sectors in most developing countries are underdeveloped and largely dominated by banking systems that play a limited role in financial intermediation. In most cases these banks cater to a limited number of clients, and mainly provide short-term credit. Non-bank financial institutions are often undeveloped in countries that suffer from lax contract enforcement, poor accounting standards, and inadequate credit information system.[3]

Accordingly, access to financial services remains low and transaction costs are high in most developing countries, with some segments in the economy having almost no access to funding. Access to finance has been identified by most developing countries, and MENA is no exception, as one of the main impediments to private sector development. Apart from the poor appetite for investment associated with the slowdown in economic growth in MENA negatively affecting the demand for credit, from the supply side, banks are often reluctant to extend loans to newly established and small-scale enterprises. Banks tend to lend to large firms with well established balance sheets, and a profitable track record. Moreover, access to medium- and long-loans is extremely limited, constraining the development of various industries that require term funding, and intensive capital equipment. At the same time, non-bank financial institutions are underdeveloped, and their role in financial intermediation is rather shallow in MENA region.

Non-bank financial institutions could play a crucial role in complementing banks by providing services that are not well suited to banks. Non-bank financial institutions could fill the gaps in financial services, and enhance competition in the financial systems.[4] Moreover, non-bank financial institutions, such as financial leasing companies could provide finance to small-scale firms that do not have sufficient collateral. It could be a way to avoid collateral problems for small-scale firms, which enables them to substitute a leasing contract with the equipment itself as collateral, and avoid having to borrow to purchase the asset. Financial leasing could also help in the provision of long-term funding, as well as overcoming various legal and tax impediments. They also have the comparative advantage of being specialized in particular sectors or catering target groups.

Financial leases are an alternative to bank loan financing of equipment purchases. The lessor buys the equipment chosen by the lessee, which is then used by the lessee for a significant period of its useful life. Financial leases are often called full-payout leases because the lease payments during the lease term usually amortize the lessor's total purchase costs—residual

1 Bencievenga and Smith (1991), Boyd and Smith (1992), Greenwood and Jovanovic (1990), Pagano (1993).

2 Fleming (2000), Vittas (1996), Carmichael and Pomerleano (2002).

3 Levine, Loayza, and Beck (1999), Demirguc-Kunt and Levine (1999), Levine (1999), Deirguc-Kunt and Makasimovic (1998), Greenspan (1999).

4 Reed and Befus (1994), Carter (1996), Balkenhol and Schutte (1996), Carmichael and Pomerleano (2002)

value of the original acquisition price—plus covering interest costs and providing some profit. The lessee bears the risk of obsolescence and the cost of maintaining and insuring the asset.

Contrary to banks, leasing does not require collateral. It is a contractual arrangement that allows the leasing company; the lessor, to retain ownership of the asset. Leasing provides a separation of ownership from use, with the lessee receiving the benefits of use and the lessor receiving the lease payment flow plus the residual value of the asset. There are no costs involved in verifying property rights of the lessee and if the latter is negligent in lease payments, enforcement and repossession are automatic and usually should not require court action. The leasing company focuses on the lessee's ability to generate cash flow to service the lease payments, rather than rely on credit history, assets or capital base. This arrangement is especially convenient for small-scale firms without a long history of financial statement, and lacking collateral. Security of the transaction is provided by the asset itself. Typically, the lessee has the right to buy the asset at the end of the lease contract. A common clause in leases is for the lessee to have the option to purchase the asset at the end of the term of the lease for a predetermined price.

The leasing industry has evolved significantly over the past 50 years. It started in the 1950s in the US and extended to Europe and Japan in the 1960s, and has been spreading through developing countries since the mid-1970s. The number of leasing companies in developing countries has been especially increasing during the last ten years. However, such rapid emergence and growing significance of leasing in developing countries has until recently remained largely unappreciated by policymakers in many countries. Policy makers' attentions have been focused on the larger and more visible institutions in financial sectors, such as banks.

Facilitating access to finance through the financial leasing industry could be economically rewarding for MENA region. Although several MENA countries have been making efforts in the past few years towards developing the leasing industry, no significant progress has taken place. The sector is being confronted with various obstacles, including deficiencies in enforcement of creditor rights, lack of adequate credit information infrastructures, and poor institutional and regulatory framework. A well developed and properly regulated financial leasing sector could be an important component of a broad and efficient financial system in MENA countries. Hence, promoting the underutilized financial institutions in MENA region is essential.

2. Methodology

There is very limited research on financial leasing in MENA countries. Although access to bank finance is a concern in MENA countries, very limited research covered alternatives to banks as the main source of finance. The objective of this paper, therefore, is to assess the performance of the financial leasing industry, to analyze the constraints and impediments confronting its development in the selected MENA countries, namely Egypt Jordan, Morocco, and Saudi Arabia, and to derive relevant policy implications. This paper will contribute to the literature on non-bank financial institutions and specifically on financial leasing in MENA countries.

The ultimate goal of the report is to influence policies, regulatory frameworks and institutional setups, in order to enhance enterprises' access to financial services, especially small-scale ones. The paper will also contribute to the understanding of the critical role the financial leasing sector could play in developing the financial markets in MENA countries, and ultimately come up with policy recommendations on how to reap the benefits of such an underutilized non-bank financial institution, which could enhance growth and development in the MENA region.

In that context, this paper is divided into four sections, in addition to the introduction, and methodology. The first section presents evidence on how the financial leasing industry could play a crucial role in financial intermediation in developing economies, focusing on its comparative advantages, and its role in enhancing access to finance and economic development. Section two analyses the financial leasing industry in MENA region, its structure and financial performance, and assesses the adequacy of the institutional, legal, and regulatory framework, while section three identifies the challenges facing the leasing industry in the selected MENA countries. The paper concludes with specific policy implications, identifying the necessary financial, legal, regulatory, and institutional framework for developing the financial leasing industry in MENA region, and enhancing its potentials in improving firms' access to finance.

The methodology adopted in this paper involves a critical and comparative analyses. The critical analysis reviews the theoretical and empirical literature related to financial leasing in emerging markets, focusing on MENA. The paper will review and assess the effectiveness of the macroeconomic, legal, and institutional framework, and the existing incentive systems, in order to identify the main impediments confronting the leasing industry. Moreover, a comparative analysis will be conducted at the cross country level, taking into account the variations in the stages of development in terms of legislation and approaches in meeting the requirements of leasing. This will help in identifying policy recommendations on how to develop the financial leasing sector in MENA region.

3. The Role of Financial Leasing in Developing Countries

The financial leasing industry can play a very important role in developing financial markets and in providing finance to enterprises, especially small-scale-ones that face problems obtaining credit from banks. Financial leasing companies have a dual role, as on one side they complement the banking sector with increasing the range of products and services but on the other side they compete with the banking sector, forcing it to be more efficient and responsive to the needs of their customers. Leasing of plant and equipment has been extensively used in many countries as a means of expanding enterprises' access to credit, including term finance.[5]

Advantages of leasing in emerging markets lie in its separation of ownership from economic use. For the lessor, ownership provides stronger security. In countries where collateral laws are not well developed or enforced by courts, secured lending of the type offered by banks can involve considerable collateral risk. Leasing offers the advantage of simpler procedures for repossession, because ownership of the asset already lies with the lessor. Other advantages to the lessee lie in allowing SMEs to have access to capital for investment. In addition, leasing enables the lessee to leverage off the purchasing strength of specialized lessor companies.

Basically, without a leasing industry, the sources of financing for small-scale enterprises, without assets to pledge as collateral, are funds from friends and relatives, suppliers' credit, moneylenders, and internal funds. However, for larger enterprises with adequate collateral, they would be a bank loan, suppliers' credit, capital markets, and internal funds. With a leasing industry, small and larger enterprises would seek leasing for equipment purchase as their financing options in addition to the other alternatives. Leasing is perceived as a

5 Leasing has the advantage over a secured loan in that, by retaining ownership of the leased asset, lessors' ability to recover their outlay in the case of default is enhanced.

substitute for debt for firms that are "too risky or are unable to access conventional debt markets".

Financial leasing could play an important role in enhancing financial intermediation, induces competition in the financial sector, and hence promote investment and economic growth. Gains acquired by the lessee include: (i) less strict requirements for historical balance sheets, giving newly established and small-scale firms access to finance; (ii) little cash required as leasing can finance a higher percentage of the capital cost of equipments than bank borrowing; (iii) lower transaction costs despite the relatively high spreads of leasing[6]; (iv) provision of medium- and long-term financing for the purchase of equipments; and (v) tax incentives as lessees can offset their full lease payments against income before tax, compared to just interest on bank loans. In addition, lessors can pass on tax benefits associated with their depreciation to lessees via reduced financing costs. Financial leasing could be a less risky transaction. Being able to retain ownership of the leased asset, the lessor is more secure in case of failure of repayment, especially if the repossession procedure is simple.

The specialized nature of leasing companies, combined with their scale, can also lead to a higher level of efficiency. They can offer efficiencies in dealing with government bureaucracies to negotiate and secure investment incentives, import licenses, and other investment related government benefits. A strong leasing market can also benefit financial sector development more generally by broadening the financial markets. In early stages of development, it is typical for leasing companies to raise their funding from wholesale sources such as banks, insurance companies, and pension funds. As they develop in sophistication, they can issue paper directly in the securities market. Once they have a sufficient credit history, they also can tap the equity markets by going public.

4. Financial Leasing in the Selected MENA Countries

4.1. Financial Leasing in Egypt

The leasing industry is not well developed in Egypt, despite its potential for supporting the development of small and medium firms, and other economic activities. The share of leasing industry of the total gross fixed investments in Egypt is remarkably low compared to other developing countries, and the number of leasing companies remains limited. Although there are 143 companies registered in Egypt, only seven are active, of which one is a "captive" firm subsidiary of non-financial firms, and are providing finance to third parties.[7] The majority of the leasing companies in Egypt are controlled by banks or bank-affiliates. Out of the remaining companies, 40 are essentially "single contract" companies[8], while 96 have never operated. The annual volume of leases is quite small, and the number of leasing contracts is quite limited[9].

The leasing industry was established in Egypt by Law 95 for the year 1995 with further amendments in late 2003.[10] Amendments allow the leasing of all assets, including cars that

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6 In contrast, bank loans entail costs of assigning collateral, documentation, and slower processing time.

7 'Captive' leasing companies are those that are wholly-owned subsidiaries of a manufacturer established to support the sales of its parent's products and services, with over 50 percent of its portfolio in the parent company's products. These leasing companies are providers of operating leases.

8 These have been established for the purpose of one-time leasing deals with their parent firms to take advantage of the five year tax holiday enjoyed by leasing.

9 In 2004 there were about LE 500 million total new leases. The total leasing contracts made were 5,554 contracts of a value of about LE 11.5 billion.

10 The amended law made two major developments: First, it allowed the leasing of cars; and second it imposed a minimum capital requirement for new entries in the industry, when previously, there was no limitation on the entrance of any company.

were not permitted under the previous law; and land as long as it is attached to a productive activity. In terms of institutional set up, since June 2004 leasing companies have come under the General Authority for Free Zones and Investment (GAFI), which is affiliated to the Ministry of Investment.[11] While the registration of the leasing companies is done by the Companies Authority (CA), regulation is the responsibility of GAFI.

Leasing companies established for the purpose of one-time leasing deals, are mainly with the objective of tax avoidance. The law grants leasing companies a five-year tax holiday on the profits that arise from their leasing activity. Such tax concessions seem to have been exploited mainly as a tax shelter for large corporations, through the establishment of captive companies. Not only are lessors exempted but lessees also mange to get a tax exemption equivalent to net savings from rentals created on the income statement, inflating expenses for the tenure of the lease.[12] This concession should be withdrawn; a vigorous leasing industry will not develop without the strengthening of legal and information infrastructures.

On the administrative front, the requirement for each leasing contract to be registered by the CA and checked for compliance with the law is a cumbersome procedure. This has been exacerbated with the changes made in the standard format of the registration contract in July 2003, which increased the time required from one week to a three to six months period. This delay is mainly attributed to the three clauses that were added to the standard leasing contract. The objective of these three clauses is to ensure that the lessor is committed to compliance with Egyptian Accounting Standards (EAS), adherence to anti money laundering and combating terrorism financing (AML/CTF), and observance of the regulations imposed by GAFI, regarding treasury, credit and portfolio management, such as lending limits and client risk exposure. Moreover, this registration process is a mere formality that provides no real benefit to the industry (charges a fees of LE 50 per contract), hindering its growth. One potential advantage that the CA could provide is to ensure that there are no multiple leases on the same equipment. However, in its current paper form, such information is difficult to obtain. Another constraining factor is the rule imposed by GAFI in 2003, requiring a minimum of 25 percent of the value of the assets to be financed from the capital of the leasing company for each contract.

Part of the reason that the leasing industry remains small is lack of understanding of the sector. There is no department responsible for regulating the sector. In addition, lack of any official statistics decreases the industry's visibility. Together with poor market conditions in Egypt, the foregoing factors have reduced the potential ability of leasing companies to reach out to its clients, especially the newly starting ones, since the leasing industry tends to rely more on banking than on leasing practices. Although the leasing industry has been stagnant during the last few years, it is expected to pick up, partially as a result of the general reluctance of the banks to extend loans, especially to small and medium firms, pushing customers to look for alternative means of financing. In general, due to various reasons, the financial leasing sector in Egypt is underdeveloped.

4.2. Financial Leasing in Jordan

The financial system in Jordan is also dominated by the banking sector. Non-bank financial institutions account for a very small portion of the Jordanian financial system, but they are growing and they have the potential to improve. The legal framework for financial leasing has been put in place recently. Nine companies have registered as leasing companies, but so far only one is active in the market.

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11 Based on the Presidential Decree 201 for 2004, establishing the Ministry of Investment.

12 In the cases where ultimately the asset goes back to the lessee.

The financial leasing industry is still underdeveloped in Jordan. The development of the sector is hindered by various obstacles. The most significant impediments hindering the development of the industry are ambiguity present between the law and the associated regulations as they contradict one another in terms of the requirements of the registration of a lease, with the regulation mentioning that registration is optional while the law indicates that in order for ownership rights to be declared, leases need to be registered. In addition, the lease registry is not operational, and the fee structure for recording is unnecessary and expensive. Systems in place should ensure quick and low-cost recordation of the lease contracts. The enhancement of the non-bank financial institutions in general, and the leasing industry in specific, would serve small and medium enterprises in a positive way. Currently, financial leasing companies are not engaged in micro leasing even though there are no legal restrictions.

Concerning the institutional set up of the leasing industry in Jordan, any entity (other than a licensed bank)[13] engaged in financial leasing must be registered with the Ministry of Industry and Trade as a financial leasing company. The minimum capital requirement for a financial leasing company is relatively high, amounting to JD 1 million. Financial leasing companies are regulated by a 2002 temporary law. It is worth noting that in Jordan a temporary law has the legal force of a law and is issued by the Council of Ministers, while the regular law is issued and ratified by the Parliament. Temporary laws are usually issued while Parliament is not in session, but Parliament has the right to review the temporary law, amend it, and reject or approve it. However, leasing would provide a good opportunity for the expansion of term financing for capital investments to small and medium enterprises, as Jordan’s lending environment relies heavily on collateral.

4.3. Financial Leasing in Morocco

The financial sector in Morocco is dominated by the banking system, and the financial leasing industry is underdeveloped. The financial institutional infrastructure in Morocco is developed, however; the financial practices are held behind. In spite of possessing all elements that could allow Morocco to be among modern financial systems, it still keeps hold of certain characteristics of centralized systems such as extensive government involvement.

The main weaknesses of the financial system relates to the vulnerability of the non-bank institutions and the weakness of the supervision. Concerning the leasing industry, twelve leasing companies exist in Morocco, eight of which are affiliates of banks. Minimum capital requirements for non-bank financial institutions lie between US $10,980 and US $2,196,000 depending on the activities of the company. Bank al Maghrib, the Moroccan Central Bank, supervises credit institutions including leasing companies, while the Ministry of Finance must approve their license after approval of the Credit Institutions Committee. According to Article 21 of the 1993 Banking Law, the Ministry of Finance will notify applicants whether they are granted the license or not within six months of receiving an application. Law No. 1-93-147 of July 6th, 1993 – referred to as the Banking Act— is the law regulating the leasing industry as it regards the activities of all credit establishments and their control. This act created a unified body of legal provisions applicable to all credit institutions. Article 8 of the Banking Act defines the leasing transactions as “transactions of renting of capital goods, equipment or tools, or of immovable property for commercial use with the possibility for the lessee of acquiring at a date fixed with the owner and not later than on expiry of the lease, all or part of the leased goods, at an agreed price taking account of at least part of the rental payments”.

13 As banks may engage in financial leasing according to the Banking Law

Major impediments to the development of the financial sector, including the leasing industry, in Morocco include the low efficiency of the legal and the judicial systems. The efforts the authorities make concerning legal improvements would only benefit the economy in the long run, for example, the creation of commercial courts is likely to bear fruit only in the long term. In addition, Moroccan legislation does not conform to international standards on AML/CTF. Another impediment is that leasing companies must have a 51 percent Moroccan ownership, thus hindering foreign opportunities not adhering to this requirement.

In order to strengthen the leasing industry, a supervisory independent body should be established so as to detect vulnerabilities at an early stage, ensure healthy competition, protect customers, and secure trust in the overall financial system. The supervisory body itself should increase its effectiveness by developing a more risk-based approach to supervision. Strengthening this industry needs further legal and judicial development and the overall financial system would benefit greatly if distortions created by taxes and price restrictions are removed or reduced.

4.4. Financial Leasing in Saudi Arabia

Saudi Arabia has recently taken the initiative to develop the financial leasing sector. Movable property registration and arrangements for the execution of collateral in lease transactions are articulated well, however; issues of enforcement and repossession of residential collateral in cases of default are legally in controversy. The framework governing the leasing industry is expected to be further fortified with the enactment of the Leasing Law which is currently under preparation.

The responsibilities for licensing and supervision of non-bank financial institutions will be more clearly defined when the new Capital Markets Law is enacted in the near future. Non-bank financial institutions are dominated, in terms of asset size, by quasi-fiscal institutions. The largest of these are the Autonomous Government Institutions (AGI), which dominate the primary market for government securities and hold a range of domestic and foreign investments. There are five specialized credit institutions, all of which extend interest-free loans for public policy purposes. Most report to Boards of Directors appointed by the Council of Ministers. The leasing companies, insurance companies, and licensed money chargers account for less than 0.3 percent of total financial system assets.

Even though the development of a healthy leasing industry in Saudi Arabia is being further promoted beyond its current stage, there are certain obstacles facing this industry. For example, leasing companies report that the central registry for all types of “movable” collateral is effective and available in the Traffic Department as movable collateral is identified upon registration by the registrant’s unique identification number, however; there is no central registry for fixed collateral. The current system lacks a commercial register that regulates financial contracts or leases secured by property, such as equipment. Further development for the industry must include: (i) improvements in the legal environment in order to guarantee easier access of the lessor to the leased asset in case of default; (ii) more transparency concerning the accounting rules and tax treatment of leases; and (iii) reductions in the administrative costs of the leasing industry. The proposed Financial Leasing Law, which is currently in its draft form, is expected to tackle such issues.

In an attempt to develop the leasing industry in Saudi Arabia, a new Credit Bureau Registry was established to facilitate access to information about the creditworthiness of clients; which is essential for the expansion of the leasing industry. In addition, two specialized financial leasing companies that were licensed recently are likely to be joined by others. It would be advantageous to the leasing companies if Article 117 of the Companies Law is amended.

Under Article 117, the total amount of bonds that a company may issue may not exceed the paid-up capital.

The Saudi Arabian market has known a similar technique to leasing which is known as *ijara*– a secured financing technique used by Islamic Banks covering both long-term leasing/lease financing and short-term hire-purchase. In financing, the Islamic bank or its leasing company purchases a piece of equipment selected by the entrepreneur and then leases it back to him. In a hire-purchase arrangement the entrepreneur may partially purchase, and partially rent the equipment. Although the concept of leasing is not totally alien to the Saudi market, still the leasing industry in Saudi Arabia is currently not yet advanced and well-established. The situation would be improved if authorities manage to reduce impediments facing this industry.

Developing non-bank financial institutions, especially financial leasing companies, should improve firms' access to credit, especially small and medium enterprises. Thus further improvements in access to credit information, legislative changes, and regulatory changes should be put in practice in order to enhance the financial system in Saudi Arabia. There is a need to protect creditors' rights, give leasing firms better access to long-term funding sources, ensure the transparency and consistence of accounting rules, and improve the dissemination of information on the leasing industry. Improvement in the repossession and enforcement climate would be most beneficial to the development of small scale leasing.

5. Challenges Facing Financial Leasing in MENA Countries

The financial leasing industry in MENA countries is facing various challenges, including, unfavorable institutional environment, lax foreclosure procedures, cumbersome repossession process, poor contract enforcement, lack of long-term funding, high transaction costs, and inadequate credit information system.

Development of the leasing industry in MENA countries has been hampered by an unsupportive institutional environment. One of the major impediments is the difficulties in the repossession of assets, related to the inadequate enforcement of ownership rights, as well as delays in the collection of overdue payments.[14] Although ownership rights are clearly defined by law, lessors have had great difficulty in achieving speedy repossession. According to the industry's estimates, the average length of time that the court takes in issuing the repossession order is around one month. However, the enforcement of the court orders still remains a major issue. This is especially striking for movable assets, where the police often find difficulty tracking down the assets and transferring them to the lessor. The legal and enforcement costs associated with repossessions are also very high. Due to the difficulties with repossessions, no significant secondary market for the resale of used machinery has developed.

Poor contract enforcement goes hand-in-hand with underdeveloped financial systems. Laws are important, but the enforcement of those laws is frequently more important for financial development. Improved contract enforcement lowers transaction costs. Countries with an underdeveloped financial system are more likely to have low levels of contract enforcement. Levine (1999) has shown a strong negative connection between the efficiency of contract enforcement and the degree of overall financial sector development.[15] Moreover, it is difficult to sue the defaulted client on a breach of contract, and the time to collect on a dishonored check takes one to five years. The lengthy resolution of dishonored checks is important for

14 Due to difficulties of repossession and the poorly developed secondary market, leasing companies often resorted to negotiations with customers and rescheduled lease.

15 Levine, Ross, 1999. "Law, Finance, and Economic Growth", Journal of Financial Intermediation, January 1999.

the leasing industry for two reasons. First, it is much easier to sue the defaulting client on the dishonored check than suing on the breach of contract. Second, the leasing industry, as well as other providers of finance, uses post-dated checks as a substitute of the promissory notes because of the stamp tax imposed on such notes. As a result of problematic repossession and limited resale options, the leasing industry moved towards "client-based leasing," where the decision of making a leasing contract is based on the creditworthiness of the clients, rather than asset-based leasing.

One of the major impediment the leasing industry faces, which is common for the financial systems in developing countries at large, is the unavailability of credit information. Data at the Credit Registry Department of the central bank in many developing countries is only available to leasing companies that operate as bank subsidiaries, while independent lessors do not have access to such information.[16] This data is often inadequate and unreliable since in some cases banks do not report on defaulting clients. Moreover, data available does not include information on potential clients, which is a problem when dealing with newly-established firms. This distorts the leasing industry and inhibits growth of the non-bank leasing companies. Some non-bank leasing companies would often resort to bank references to know the creditworthiness of their clients, after getting authorization from the client. However, banks are not always efficient and prompt in providing such references.

Another constraint is the lack of long-term funding or its relatively high cost when available. Leasing companies usually obtain most of their funding from their sponsor banks, which is often of short-term nature. However, the leasing companies that are not affiliated to banks have a bigger problem in terms of access to finance. Unlike deposit-taking institutions, which transform short-term deposits into longer-term loans, leasing companies need to broadly match their assets and liabilities (a leasing company that borrow six month funds cannot write a three year lease without incurring a refinancing risk). Mismatches can occur in several ways: term, interest rate or exchange rate. Domestic financial markets often provide leasing companies with relatively short-term financing, meaning that there is a danger of a leasing company mismatching the average term of its assets (outstanding leases) and liabilities (its borrowings). Moreover, the relatively limited development of capital markets and the current domestic economic situation do not support the issuance of bonds to provide for long-term funding and the small size of the leasing companies may not allow them to access the primary bond market. As a result, the length of the leasing contracts is shortened, reaching an average maturity of three years. Only in countries where there is a yield curve that banks could use it as a good benchmark for extending long-term loans.

6. Conclusion and Policy Implications

A well developed, diversified, and efficient financial system can spread risk and provide a sound base for sustainable economic development. Empirical studies show that countries characterized by financial deepening tend to enjoy faster economic growth. Development literature has indicated that countries characterized with a diversified financial system, and a well developed non-bank financial institutions are more resilient to shocks. Nevertheless, the financial sectors in most developing countries are underdeveloped, and the Middle East and North African (MENA) countries are no exception. They are largely dominated by banking systems, mainly catering to a limited number of clients, and providing short-term credit, while the role of non-bank financial institutions in financial intermediation is rather shallow.

16 Banks have helped their affiliate leasing companies to have access to credit information on potential customers, either through their credit departments or through the Credit Registry Department at the CBE, which currently is available only to banks.

As a result, access to finance remains low and transaction costs are relatively high in MENA countries, mainly due to poor institutional and regulatory framework in terms of lax contract enforcement, inadequate collaterals, poor accounting standards, and a weak credit information system. Non-bank financial institutions, especially the financial leasing sector could improve access to finance in MENA through the provision of long-term funding, overcoming collateral requirement, and other legal and tax impediments. This is especially crucial for newly established and small-scale firms that do not have adequate collateral, and historical financial statement, and of which financial statements are noncompliant with the international accounting standards. Leasing companies, unlike banks, are more concerned with the lessee's ability to generate cash flow to service lease payments, rather than rely on its credit history, assets, or capital base. Financial leasing could play an important role in enhancing financial intermediation, induces competition in the financial sector, lower transaction cost, and hence promote investment and economic growth.

Leasing companies could have various means for mobilizing funds and should broader their finance options. In addition to borrowing from banks, they could resort to pension funds and insurance companies, these institutions can provide longer-term finance. Another option is for the leasing companies to issue bonds or other marketable instruments, which would broaden the choice and liquidity of instruments on domestic capital markets. Leasing companies often enhance the security of the bond by giving purchasers a claim to the underlying basket of lease receivables. This makes the bond attractive to a wider range of potential buyers. This will ultimately help in deepening and broadening domestic capital markets. Lessors need medium-term funding to write medium-term leases.

The leasing industry is underdeveloped in MENA, despite its potential for supporting the development of small and medium firms, and other economic activities. A well developed and properly regulated financial leasing sector could be an important component of a broad and efficient financial system, and economically rewarding for MENA countries. Developing the leasing sector in MENA region could facilitate access to finance, and address deficiencies in the infrastructure of the financial sector, as well as, overcoming legal and regulatory shortcomings. Financial leasing companies have a dual role as on one side they complement the banking sector with increasing the range of products and services, while on the other side they compete with the banking sector, forcing it to be more efficient and responsive to the needs of their customers. It is therefore crucial to enhance the role of financial leasing companies through addressing the various obstacles confronting this sector.

In order to enhance the role of financial leasing companies, various legal, and institutional reforms are required. A supportive regulatory environment and a strong judicial system is crucial for assigning clear property rights, enforcing foreclosures, and the adequate repossession of assets in case of default. Effective and timely repossession and enforcement procedure and protecting creditors' rights in case of lessee default is crucial for the development of the leasing industry. This includes the automatic right of repossession without lengthy court proceedings and the right to claim payments due. When the process of asset repossession is streamlined, leasing companies tend to take riskier business, and price their leases with a lower risk premium. At the same time, the lessee is obliged to make timely lease payments. A properly functioning and strong judicial system is an effective way for protecting creditors' rights. In terms of supervision, it is important to set clear guidelines and have a strong supervisory body to ensure compliance with prudential regulations related to maximum debt-equity ratios, minimum capital requirements, ability to raise retail deposits, and the mandatory provision of transparent and standardized financial statements.

Access to timely, accurate, and reliable information on clients' creditworthiness is crucial for the development of financial leasing in MENA countries. It is therefore essential to make the necessary legal amendments to allow for financial leasing firms' access to public credit registries at the central banks. An alternative strategy for expanding access to credit information would be to allow the establishment of a full scale private credit bureau, which would be majority owned by the banking sector. A vigorous leasing industry will not develop without strengthening the information infrastructures. Imposing accounting standards that are in compliance with the International Accounting Standards (IAS), and adherence to AML/CTF is a good step forward. There is a need to ensure the transparency and consistence of accounting rules, and improve the dissemination of information on the leasing industry.

The tax and accounting regulations of the country determine which party—the owner or the user of the asset—may depreciate the asset. Some countries use fiscal incentives, such as tax exemptions to encourage capital investments and provide finance to small-scale and newly established firms that are often denied access to other financial institutions, such as banks and the stock market. However, leasing companies should operate in a fiscal environment that provides equal treatment to the financial leasing sector compared to other sources of capital investment funding. In that context, it is argued that tax holiday granted to leasing companies should be withdrawn. Nevertheless, it is argued that the fiscal loss from such incentives is often limited as new leasing companies, as well as small-scale firms and new enterprises usually do not have sufficient taxable income to offset depreciation or to make the deduction of the full lease payment useful.

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