Ukrainian Leasing Market 2007
Survey Findings

Ukraine Leasing Development Project
Kyiv, Ukraine

International Finance Corporation
World Bank Group

EVD international business and cooperation
Ministerie van Economische Zaken
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I. INTRODUCTION

Over the past three years, the leasing market in Ukraine has experienced rapid expansion. Foreign banks are now entering the market, increasing access to finance and the availability of financial instruments like leasing. The trend is expected to continue as more banks set up leasing companies and awareness of leasing as an alternative financial instrument grows. In an effort to identify the opportunities that exist for investors, IFC’s Ukraine Leasing Development Project (ULDP) conducted its third annual survey of the leasing market in 2007.

1. Purpose of the Survey

The main objectives of this survey are to identify:

- opportunities for local and foreign investment in the leasing market in Ukraine;
- key areas of growth in the leasing market;
- impediments to further growth in the leasing sector.

This survey gives investors and managers of leasing companies a tool for self-assessment within the industry. The Ukrainian Leasing Association, other development projects, and training companies may gain directions for future educational or policy initiatives. Regulators receive confirmation for planned legal or regulative measures and investors and research analysts can focus their analysis on key aspects of the leasing market in Ukraine.

We hope to contribute to the further strengthening of the leasing sector in Ukraine, which is crucial for achieving the nation’s ambitious economic development goals, especially for small and medium enterprises. IFC would like to thank those leasing companies that participated in this survey. The survey was made possible due to their willingness to provide detailed information on their companies and their understanding of the importance of leasing for Ukraine.

2. Methodology

The survey covers 60 leasing companies that responded to a questionnaire sent to the 65 officially registered leasing companies in Ukraine. Leasing companies that are wholly owned by the state were excluded. The poll of 60 surveyed leasing companies covers all Ukrainian regions and represents over 90% of the leasing sector’s total assets as of December 31, 2006. In order to track the development of leasing in Ukraine, the questionnaire is built on the same concept as the survey of the leasing market in Ukraine conducted by the Ukraine Leasing Development Project for the previous two years, covering 46 questions in five categories:

1. General Information about the Leasing Company (Contact Details, Total Equity, Total Assets);
2. Information about Lease Agreements;
3. The Legal Aspects of Leasing;
4. Financial and Economic Aspects of Leasing; and
5. Additional Questions (includes awareness of the Ukraine Leasing Development Project activities).

Minor changes, where needed, were made to the survey questionnaire from the previous year.
Where survey information was incomplete, the Ukraine Leasing Development Project staff conducted interviews with leasing company personnel to ensure a complete picture of the market. Since over 90% of the registered Ukrainian leasing companies responded to the survey, it is possible to extrapolate the leasing market as a whole from the results of this survey.

The survey team commenced its work in March 2007. Leasing companies received their questionnaires in March 2007 and data entry was closed June 1, 2007. A presentation of the survey findings was presented to the press and stakeholders on June 7, 2007 at the World Bank Office in Kyiv. IFC and World Bank officials, Government officials, leasing companies and the Ukraine Leasing Development Project staff took part in the Round-Table discussion following the presentation.

3. Why Leasing matters for Ukraine

Leasing is a short or medium-term financing technique for the procurement of machinery, equipment, vehicles and/or properties. Leasing provides a mechanism by which an enterprise makes a small upfront payment to secure the right to use an asset and then makes the remaining payments from cash flows generated from the use of the asset. In these cases, profits are earned through the use of assets, rather than from their ownership. This, financing of assets through leasing leverages the ability of small and medium enterprises to generate cash flow from business operations to service lease payments.

As a financial instrument, leasing has played a crucial role in stimulating investment in productive assets all over the world. In OECD countries, leasing currently accounts for approximately 15-30 percent of all investment in capital assets. In developing countries, this figure is lower, in the range of 0-15 percent. Yet, the true value of an instrument such as leasing is felt in developing economies. Enterprises in these countries typically do not have the resources to buy capital intensive equipment outright, and typically long-term big-ticket loans are not available from banks.

In Ukraine it is expected that improved access to leasing will assist in the financing of new capital assets to increase production across a range of industries, generating jobs and improving local living conditions. Small and medium enterprises will likely benefit most from the development of leasing in Ukraine as many of them do not qualify for bank financing and lack the capital to purchase fixed assets to grow their businesses. This will help to open the Ukrainian market to both domestic and foreign equipment suppliers, particularly in the agribusiness sector.

4. The Ukraine Leasing Development Project

The Ukraine Leasing Development Project was launched in 2004 with support from the Dutch Agency for International Business and Cooperation. The project’s objective is to support the development of the sustainable leasing industry in Ukraine by using international best practices in advising leasing companies, government agencies, businesses and education institutions on leasing issues and promote investment in the leasing sector of Ukraine.

The Project works to:
• Facilitate the development of an effective legislative environment for leasing in Ukraine;
• Provide training and consulting to local enterprises and financial institutions interested in using or offering leasing in Ukraine;
• Build business opportunities for local enterprises and foreign equipment suppliers as well as foreign leasing investors;
• Conduct a national public awareness campaign to educate private enterprises, financial institutions and regulatory agencies about leasing.
II. EXECUTIVE SUMMARY

Over the past three years, the leasing market in Ukraine has experienced rapid expansion. Foreign banks are now entering the market, increasing access to finance and the availability of financial instruments like leasing. The trend is expected to continue as more banks set up leasing companies and awareness of leasing as an alternative financial instrument grows.

In an effort to identify the opportunities that exist for investors, IFC’s Ukraine Leasing Development Project conducted its third annual survey of the leasing market. Key survey findings include:

- During 2006, the number of active leasing companies increased by 30 percent. This increase was driven by several factors: higher interest in leasing on the part of foreign-owned banks that entered the market the previous year; increased public and governmental awareness, rapid development of financial markets in Ukraine, and better access to and greater availability of credit sources.
- The total value of the leasing portfolio grew by over 108 percent from $344 million in 2005 to $716 million in 2006. The number of employees in the leasing industry also increased by 50 percent to reach almost 1400 people.
- Automobiles and rail transport command a large share of the leasing portfolio. The survey also revealed growth in municipal and freight transport, agricultural machinery, and non-food production equipment, although absolute numbers remain small.
- Small and medium enterprises have yet to take advantage of leasing in significant numbers. Large enterprises are still the main customers of leasing products.
- The funding base for leasing became more diversified: the share of non-resident bank loans increased by 14 percent and now commands almost a quarter of the funding base. This figure is expected to grow in the next few years as more foreign banks fund resident leasing companies.
- The leasing industry is becoming more stable, as the average share of longer-term contracts (three to five years) grew by 13 percent in 2006.
- While almost every leasing company reported defaults of payments over the last year, the percentage of repossession is small (less than one percent), and most assets are repossessed using the established legal mechanisms.
- Compared to its neighbors, the Ukrainian leasing market is still small: only 0.63 percent of GDP, compared to 4.7 percent in Hungary or 1.1 percent in Russia.¹

Though the potential for continued growth in the leasing industry remains high, there are still obstacles to be addressed. Respondents to the survey listed the following restraints to the expansion of the leasing industry:

**Access to Finance:** The cost of leasing is still relatively high for lessees and, therefore, small and medium enterprises have yet to discover the benefits of leasing. Advance payments are required in most cases – on average, 20 percent of the cost of the asset. Interest rates are often higher than bank credits, and many require collateral other than the asset itself. The local banks that fund leasing companies do not have a proper understanding of leasing and often see leasing companies as competitors. Therefore, application processes are very complicated and lengthy. Leasing companies that have easier access to finance, such as

¹ World Leasing Yearbook 2007, Euromoney Yearbooks.
foreign leasing companies, are requiring less advance payments and collateral, if at all, and are basing their credit decisions on a cash-flow basis rather than credit history. They are also introducing simpler procedures for leasing applications. As more of these players enter the market, competition will increase and small and medium enterprises will have more access to leasing.

**Tax Legislation and Administrative Reform**

In the current tax code, there are slight tax disincentives for leasing. If the draft of the amended Tax Code is approved (expected by the end of 2008), leasing will become less expensive for the lessee, thus increasing overall demand for leasing products. The government of Ukraine has expressed the idea that leasing will be an important component of its campaign to improve the climate for capital spending on equipment by amending tax legislation to include accelerated depreciation and VAT refunds for all companies. Even if the Tax Code is passed, however, there will still be improvements necessary to the administrative and judicial systems to facilitate quicker and less expensive repossession, which will reduce costs for the lessor.

**Lack of Knowledge**

In order to reach small and medium enterprises, more awareness about leasing is needed. While IFC and other donors have conducted public awareness campaigns about leasing and journalists have begun to write about it, only large enterprises, it seems, are taking advantage of the instrument. To add to the confusion, one local bank even advertises its “leasing services” that are no different from bank credits. Informational campaigns need to continue.

**Absence of Secondary Market for Fixed Assets**

Although there is a huge demand for the replacement of fixed assets in many sectors, including the agricultural and medical sectors, leasing companies are reluctant to lease assets that are not liquid. For example, there is a well-established secondary market for automobiles and automobiles are a large part of the portfolio. While it is expected that automobiles will continue to be leased in large numbers, as in countries with more developed leasing markets, the agricultural and medical sectors are underserved.

**Undeveloped Credit Bureaus**

Leasing companies have difficulty analyzing potential lessees because of lack of available credit histories. In countries where leasing comprises a significant percentage of capital investment, procedures are simplified by the fact that a quick call can reveal a potential client’s credit history. In Ukraine, obtaining credit histories is much more difficult. There are only three credit bureaus working, and they have only been in effect since December 2005. Some leasing companies amass their own credit histories of their clients, but do not share this information with the credit bureaus. One such company has collected information on 8,000 farmers and food-processors, giving it a competitive advantage in the agricultural sector. As the credit bureaus develop, leasing companies will find it easier to evaluate clients and the volume of leasing transactions will increase. Leasing companies will then use information from the credit bureaus to tailor products for customers that are easier to use and targeted at specific sectors.

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Despite all these impediments, leasing has arrived in Ukraine and is expected to reach $4 billion within the next three years. Many experts contend that this figure could be higher if
the legislative environment was more favorable and there was more access to cheap capital. Large entities, in particular, have begun to take advantage of leasing products. However, in more mature leasing markets, small businesses make up a large share of the client base. Leasing is regarded as a way to provide access to credit for enterprises which do not have significant asset bases. In Ukraine, however, small businesses have yet to take advantage of leasing in large numbers. This will change as awareness about leasing increases, the cost of leasing decreases, and the application processes simplify. Furthermore, as leasing companies get more used to term debt with cars, they will start diversifying into other types of equipment. In other words, leasing companies have yet to exploit their largest potential market.
III. FINDINGS OF THE SURVEY

Number of Leasing Companies:

In 2006, the number of leasing companies that conducted leasing transactions in Ukraine on a regular basis increased by 30% compared to the previous year (from 50 to 65 companies). Of these, 60 participated in the survey.

Diagram 1

![Diagram showing the number of non-state leasing companies with current leasing operations from 2004 to 2006. The numbers are 34, 50, and 65 respectively, with 2005 and 2006 showing a 30% increase from 2004.]
During the survey period, the average number of employees of leasing companies increased by 48%, from 942 people in 2005 to 1,393 people in 2006 (see Diagram 2). Some leasing company executives have noted that an impediment to growth is the difficulty in finding qualified leasing professionals.

**Diagram 2**

Number of Employees in Leasing Industry

- 2003: 286
- 2004: 756
- 2005: 942
- 2006: 1,393
Regional Distribution of Leasing Companies

The majority of surveyed leasing companies (66%) is located in Kyiv (see Diagram 3), although, as expected, more and more leasing companies are working in the regions. Responding to increased demand for new machinery throughout Ukraine, 28% of the surveyed companies have representative offices/branches in other regional centers of the country.

Diagram 3

Regional Distribution of Leasing Companies in 2006 (by main office)

- Kyiv: 66%
- Donetsk: 2%
- Dnipropetrovsk: 8%
- Odessa: 6%
- Lviv: 6%
- Zaporizhzhya: 9%
- Ternopil: 3%
Growth of the Leasing Market in Ukraine

During the last two years, all indicators of the leasing market in Ukraine signify dynamic growth. We can assess the leasing market volumes based on several measures: total value of assets that were leased out during the year; total value of leasing agreements made during the year; and total value of the leasing portfolio.

In 2006, the total value of assets that were leased out more than doubled compared to 2005. During this period, the total value of leasing agreements increased by 149% to $673 million (see Diagram 4). In 2006, these indicators significantly increased compared to the previous period. There is rising interest in leasing as an alternative financial instrument, and, albeit on a small scale, businesspeople are learning how to use leasing as a complement to bank credits, improving overall access to credit in Ukraine.

Diagram 4
As of January 1, 2007, the value of the leasing agreements portfolio had increased by 108%, from $344 million at the beginning of 2006 to $716 million (see Diagram 5).

**Diagram 5**

**Growth of Leasing Portfolio**

![Diagram showing the growth of leasing portfolio from 2003 to 2006. The values are as follows: 2003 - $86 million, 2004 - $201 million, 2005 - $344 million, 2006 - $716 million.]

**Number of Leasing Agreements**

An increased number of leasing agreements reflects a positive trend in the development of the leasing market. In 2006, there were 6,089 total agreements, which is a 140 percent increase over 2005 (2,534 agreements). The most agreements by a single company reached 1,223 in 2006, increasing drastically from 2004 (318) and 2005 (382).

**Advance Payments**

Almost all leasing agreements require advance payments to be paid by the lessees. Sizes of advance payments vary. According to the survey results, an average advance payment is 20 percent of the leased asset’s value, down from 21 percent in 2005. There is growing anecdotal evidence that advance payments are getting slightly smaller, and in rare cases are not required at all. As some leasing companies are becoming more familiar with the industry sectors, advance payments are a less important part of the lease agreement and the leased asset itself is regarded as sufficient collateral.
Structure of the Leasing Portfolio

By the end of 2006, the majority of leasing companies leased out several types of assets. As in most countries, the most popular items leased on the Ukrainian market were means of transport; 62 percent of the surveyed companies leased cars. This was also the case in the previous year.

Freight transport/trucks ranks second in popularity of assets leased (52 percent of leasing companies work with this type of asset). It is followed by production equipment (33 percent) and passenger transport (30 percent).

The analysis of the leasing agreements portfolio in terms of asset value shows that by the end of 2006, the biggest share in the leasing agreements portfolio was for railway transport (almost 39 percent, or $249 million — see Diagram 6). The Ministry of Transport has demonstrated an increased interest in leasing as a way to renovate fixed assets. The Ministry of Health is also exploring leasing as a way to replace medical equipment, and a general lack of awareness of leasing in the health sector. Lastly, municipalities are seeking investment in communal services (heating systems and garbage collection) and municipal transport. In the next five years, contracts like these should continue in the public sector.

For the majority of leasing companies, however, automobiles continue to be the largest share of the leasing portfolio – $141 million. Underdeveloped sectors include medical equipment, agricultural machinery, and production equipment (food processing and non-food processing).

Diagram 6
Average Term of Leasing Agreements

The average term of leasing agreements is two – three years (see Diagram 7).

**Diagram 7**

In 2006, the number of contracts with terms for up to three years decreased in favor of long-term contracts: the number of contracts with terms for three – five years grew from seven percent in 2005 to 20 percent in 2006. This finding indicates that the industry is becoming more stable. As more foreign banks enter the market, longer-term financial resources are becoming available.
Financial Sources of Leasing Activity

Based on the survey results, the funding base for leasing became more diversified in 2006. A large portion, 60 percent, of the funding sources for leasing agreements came from resident banks, which is considerably less than 74.4 percent in 2005 (see Diagram 8). The share of non-resident bank loans increased by 14 percent and now commands almost a quarter of the funding base. This figure is expected to grow as more foreign bank-owned leasing companies enter the market in the next two – three years. Commercial credits extended by suppliers decreased slightly and funding from international finance organizations grew somewhat.

Diagram 8

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resident Banks</td>
<td>60.1%</td>
</tr>
<tr>
<td>Non-Resident Banks</td>
<td>23.1%</td>
</tr>
<tr>
<td>Suppliers</td>
<td>0.8%</td>
</tr>
<tr>
<td>International Finance Organizations</td>
<td>6.9%</td>
</tr>
<tr>
<td>Other</td>
<td>0.8%</td>
</tr>
<tr>
<td>Self-financed</td>
<td>7.1%</td>
</tr>
</tbody>
</table>

Categories of Lessees

During the survey, lessees were divided according to the definition provided in the Economic Code of Ukraine of January 1, 2004:

- individuals;
- small enterprises, with gross revenues less than €500,000 ($670,000 as of June 27, 2007);
- medium enterprises, with gross revenues from €500,000 to €5 million ($670,000 - $6.7 million); and
- large enterprises, with gross revenues exceeding €5 million ($6.7 million).

While the majority of leasing companies provided services to all four categories, the bulk of the leasing portfolio was still allocated to large enterprises (75%), as more large companies are aware of the benefits of leasing, have credit histories, and the resources to pledge
collateral and advance payments. Small and medium businesses so far make up a small portion of the leasing portfolio (see Diagram 9). The average transaction size has reduced from $136,000 to $117,000 indicating a trend to smaller leasing agreements which will reach smaller players if this trend continues. If the impediments to leasing are reduced – access to finance, more convenient application processes, tax legislation that make leasing sometimes expensive for smaller players, lack of knowledge about leasing, absence of credit bureaus and secondary markets – more and more smaller businesses will have access to leasing as a means to replace equipment and increase revenue.

**Diagram 9**

<table>
<thead>
<tr>
<th>$ million</th>
<th>Individuals</th>
<th>Small enterprises</th>
<th>Medium enterprises</th>
<th>Large enterprises</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>4</td>
<td>7</td>
<td>8</td>
<td>24</td>
</tr>
<tr>
<td>2005</td>
<td>24</td>
<td>34</td>
<td>50</td>
<td>94</td>
</tr>
<tr>
<td>2006</td>
<td>94</td>
<td>148</td>
<td>122</td>
<td>155</td>
</tr>
<tr>
<td>537</td>
<td></td>
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</table>

The Development of Leasing in the Ukrainian Economy:

While the volume of leasing as a part of the gross domestic product demonstrates considerable growth, from 0.14% in 2003 to 0.63% in 2006 (see Table 1), the experience of Ukraine’s neighbors, such as Russia and Hungary, suggest that this figure could be much higher. Some experts contend that if tax legislation were amended to allow for accelerated depreciation and more favorable VAT levies, then the rate of operational leasing would increase tremendously to become a more significant proportion of GDP.

**Table 1**

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td><em>Proportion of the volume of leasing agreements and GDP</em></td>
<td>0.14%</td>
<td>0.5%</td>
<td>0.31%</td>
<td>0.63%</td>
</tr>
</tbody>
</table>
Table 2

The table below demonstrates that leasing as a financial tool to invest in fixed assets is also growing in size but has yet to reach its optimum potential. The potential for the leasing market remains huge as fixed assets need to be replaced throughout the country in all sectors.

<table>
<thead>
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</tr>
</thead>
<tbody>
<tr>
<td>Proportion of investments in fixed assets through leasing and total investments in fixed assets (capital investments)</td>
<td>0.73%</td>
<td>1.15%</td>
<td>1.46%</td>
<td>2.70%</td>
</tr>
</tbody>
</table>

Conclusion

Despite all these impediments, leasing has arrived in Ukraine and is expected to reach $4 billion within the next three years. Many experts contend that this figure could be higher if the legislative environment was more favorable and there was more access to cheap capital. Large entities, in particular, have begun to take advantage of leasing products. However, in more mature leasing markets, small businesses make up a large share of the client base. Leasing is regarded as a way to provide access to credit for enterprises which do not have significant asset bases. In Ukraine, however, small businesses have yet to take advantage of leasing in large numbers. This will change as awareness about leasing increases, the cost of leasing decreases, and the application processes simplify. Furthermore, as leasing companies get more used to term debt with cars, they will start diversifying into other types of equipment. In other words, leasing companies have yet to exploit their largest potential market.
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