

# THE IMPACT OF RECENT LEASING ACTIVITY ON THE FINANCIAL SYSTEM IN THE REPUBLIC OF NORTH MACEDONIA

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## Abstract

Leasing is an activity that refers to movable and immovable goods, in which the lessee determines the subject of leasing that is purchased or produced by the lessor and is given to the lessee for use for an agreed period, in exchange for payment of compensation for the use of the subject of leasing, based on the leasing agreement concluded between the provider and the lessee, according to the conditions specified in it. Leasing is an alternative way of financing where it is necessary to emphasize the use of the leased goods, and not the ownership over them (use but not possess), i.e. the philosophy of leasing arises from the idea of profitable use of an investment goods followed by a flexible method of payment that allows investment without the additional engagement of core capital, successful operation and maximum utilization of funds. In addition to the primary financing function that the leasing activity has for the lessee, if he uses the leased goods for business purposes, leasing in that case can also have an investment function. Regulated by the Law on Leasing, leasing activity in the Republic of North Macedonia has a fairly short lifespan, focusing exclusively on financial leasing. Through analysis, synthesis, and statistics, the authors processed the official data of the Ministry of Finance presented by the National Bank in the period mainly of the last decade, which offers a clear picture of the movements of the use of leasing in the country.

*Keywords:* leasing activity, lessor, lessee, financing, use, Republic of North Macedonia, Ministry of Finance, National Bank

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## 1. Introduction

Leasing, along with sales and credit, represents one of the three main methods of financing the supply of business equipment. While the last two are forms of title financing, the security of the creditor to ensure that all of his privacy to the item or other rights as granted by the lease are in contrast to the loan in which the creditor advances funds on security and sends owned by the debtor. Of course, many sales and leases are not financing instruments at all, as they are not designed to provide financial accommodation. A typical financing sale is one in which the creditor reserves title until full payment of the purchase price by the buyer. Leasing, as a method of financing, is structured in such a way that it provides the creditor with reimbursement for his expenses for the item and the desired return of capital.<sup>1</sup> Today, almost any item and equipment that can be purchased can also be leased: from airplanes, ships and other means of transport, satellites, computers (hardware and software), refineries, on the one hand, to printing presses, and automobiles on the other hand.<sup>2</sup>

A contract for the lease of goods is a contract under which one party, the lessor, undertakes to provide the other party, the lessee, with a temporary right of use of goods in exchange for rent. The rent may be in the form of money of other value.<sup>3</sup> A consumer lease is a contract under

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<sup>1</sup> Roy Goode, Herbert Kronke, Ewan McKendrick, *Transnational Commercial Law* (2<sup>nd</sup> edition), Oxford: Oxford University Press, 2015, 355.

<sup>2</sup> Peter K. Nevitt, Frank J. Fabozzi, *Equipment Leasing* (4<sup>th</sup> edition), New Hope: Frank J. Fabozzi Associates, 2000, 3.

<sup>3</sup> Article 1:101 of the *Principles of European Law: Lease of Goods (PELLG)*, Study Group on a European Civil Code, Munich: Sellier European Law Publishers, 2008, 1.

which a business leases goods to a natural person who is acting primarily for purposes that are not related to that person's trade, business, or profession (the consumer).<sup>4</sup>

Such leasing operations can be carried out by a commercial or industrial company if they are done on an occasional basis; if they are carried out regularly, the lessor must be a credit establishment. To be valid, such agreements must relate to goods used for professional purposes, and such goods must be purchased by or constructed for the account of the company which will be the lessor. The price that the lessee will pay for the property if it chooses to exercise its purchase option must consider at least partially the payments made under the leasing arrangement.<sup>5</sup>

A lease contract is a contract in written or electronic form, concluded between the lessor and the lessee, by which the lessor provides the asset of use to the lessee, under conditions specified in the contract for a certain period of time.<sup>6</sup> The lessor and lessee will enter into an agreement that specifies the property which is the subject of the lease contract; the lessor will grant a power of attorney to the lessee to take possession of the property as agent of the lessor. The property of leasing is any movable and immovable asset that is given to the use of the user, except for the one that is restricted by law to be the subject of leasing.<sup>7</sup> The lessor is free to set the lease payments at any rate as it is not bound by usury provisions. The lessee must maintain the property and in certain cases must insure it; in exchange, the lessee enjoys the warranty for hidden defects and quiet enjoyment (unless the parties agree otherwise).<sup>8</sup> The lease contract may provide for the right to purchase the asset by the lessee on the day or before the expiration of the agreed period for using the asset, and/or the right for the user to continue using the asset of leasing after the expiration. This usually happens at a bargain purchase price. Furthermore, the lease contract may require that the leased asset have a stipulated market value at the end of the lease term. If it does not, the lessee is required to pay the difference between the leased asset's actual market value at the end of the lease and the fair market value it should have had as stated in the lease contract.<sup>9</sup> However, after the expiration of the lease contract, the lessee will not automatically acquire ownership of the asset after paying all fees resulting from the lease contract.<sup>10</sup> Moreover, the legislator orders that the lessor or the lessee are obliged, in written or electronic form, to submit a request on a prescribed form for the registration of the asset that is the subject of the lease contract in a special register that is kept in the Central Register.<sup>11</sup>

The term of the lease depends upon the type of the asset. The lease period usually coincides with the economic life of the asset (it may extend from five to fifteen years or more) and may be categorized into primary and secondary lease periods. During the primary lease period (the desired pay-back period), the lease rates are so fixed as to repay the lessor's principal as well as interest. The secondary period is for the balance of the life of the asset when only nominal rentals are changed to continue the agreement till the lease period is over.<sup>12</sup>

The regulation of the manner and conditions of exercising the leasing activity, the subject of leasing, and the rights and obligations of the parties in the lease contract, in our country are done through the provisions of the Law on Leasing. In addition, the provisions of the Law on Obligations<sup>13</sup> apply to the lease contract in an appropriate manner. At the international level,

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<sup>4</sup> Article 1:102 of the *Principles of European Law*, 1.

<sup>5</sup> Christopher Joseph Mesnooh, *Law and Business in France: A Guide to French Commercial and Corporate Law*, Dordrecht: Martinus Nijhoff Publishers, 1994, 256.

<sup>6</sup> Article 2(8) of the *Law on Leasing*, Official Gazette of the Republic of North Macedonia, no. 04/02, 49/03, 13/06, 88/08, 35/11, 51/11, 148/13, 145/15, 23/16, 37/16.

<sup>7</sup> Article 2(7) of the *Law on Leasing*.

<sup>8</sup> Article 9(1) of the *Law on Leasing*.

<sup>9</sup> G. Stevenson Smith, *Managerial Accounting for Libraries & other Not-Profit Organizations* (2<sup>nd</sup> edition), ALA Editions, 2002, 192.

<sup>10</sup> Article 10 of the *Law on Leasing*.

<sup>11</sup> Article 12(1) of the *Law on Leasing*.

<sup>12</sup> E. Chandraiah, *Evaluation of Lease Financing*, New Delhi: Concept Publishing Company, 2004, 38.

<sup>13</sup> *Law on Obligations*, Official Gazette of the Republic of North Macedonia, no. 18/01, 04/02, 05/03, 84/08, 81/09, 161/09, 23/13, 123/13, 215/21, 154/23.

the UNIDROIT Convention on International Financial Leasing<sup>14</sup> remains the most serious comprehensive leasing effort. The number of ratifications is not the only measure of the success of the Convention. It has influenced the domestic legislations of several countries, forming the model adopted by them, but also created the basis of work that led to the UNIDROIT Model Law on Leasing.<sup>15</sup>

## **2. The path of leasing regulation in the Republic of North Macedonia**

In the normative practice of the Republic of North Macedonia, two phases for the regulation of leasing can be distinguished. For the first phase, it is characteristic that leasing for the needs of foreign trade was regulated by the Law on Foreign Trade Activity, while in the domestic trade, in the absence of domestic legislation, the Law on Obligations were applied, and in particular the provisions of the contract of sale which refer to the sale with the right of retention of ownership (Articles 570-602 of the Law on Obligations), then the lease contract (Articles 670-602 of the Law on Obligations); of the loan contract, due to the payment of the leasing fee (articles 1104-1107 of the Law on Obligations). The second phase marks the entry into force of the Law on Leasing. In this case, it should by no means be considered that the application of the Law on Obligations is excluded, because its provisions as *lex generalis* on contractual relations will be applied to the relations created by the leasing activity whenever the provisions of the Law on Leasing are missing. Furthermore, it is worth noting the impact of the Law on Banks, according to which leasing is one of the activities of the bank.<sup>16</sup>

The frequent and numerous changes to the Leasing Law indicate instability in the leasing sector, in terms of changing existing rules, but also of 'importing' new rules mainly from countries with more developed practices and more traditional during the lease. The changes in question simultaneously aim to increase the level of interest and use for this activity.

## **3. Applicability of leasing in the practice of the Republic of North Macedonia**

The leasing sector continues to have a small role and significance for the domestic financial system and does not represent a more significant channel for risk spillover to other segments of the financial system, both due to its small volume and weak connection with other segments of the financial system. This is proven by the almost insignificant number of seven companies that offer leasing services.<sup>17</sup>

After a period of five consecutive years of decrease in activities, in the last two years, the leasing sector has revived, achieving double-digit growth rates of activities. Consequently, the share of this sector in the assets of non-deposit financial institutions and the total assets of the financial system increased, but it is still small and amounts to 4.7% and 0.8%, respectively. The small importance of leasing companies for overall financial stability is seen through their weak connection with other segments of the financial system. Leasing companies' deposits with domestic banks account for 2.9% of the leasing sector assets and an insignificant 0.03% of the total assets of the banking system. Liabilities to loans to domestic banks represent 4.2% of the sources of funds in the leasing sector and 0.04% of the assets of the banking sector.<sup>18</sup>

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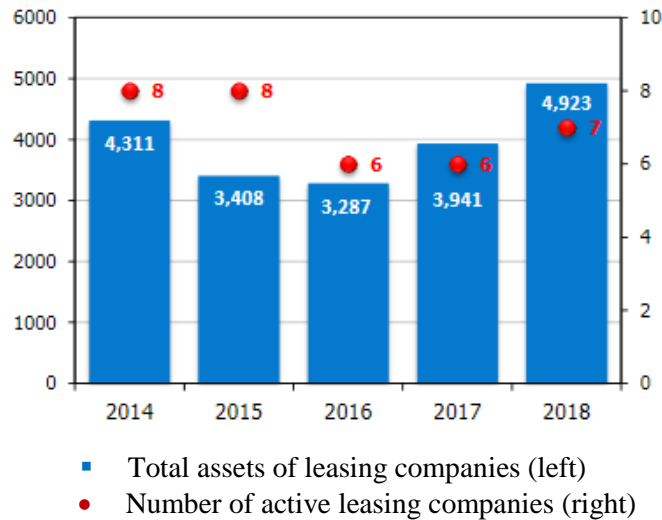
<sup>14</sup> UNIDROIT Convention on International Financial Leasing (1988).

<sup>15</sup> UNIDROIT Model Law on Leasing (2008).

<sup>16</sup> Articles 2(34) and 7(1) of Law on Banks, Official Gazette of the Republic of North Macedonia, no. 67/07, 90/09, 67/10, 26/13, 15/15, 153/15, 190/16.

<sup>17</sup> [https://finance.gov.mk/wp-content/uploads/2023/09/Registar\\_Septemvri-2023\\_2.pdf](https://finance.gov.mk/wp-content/uploads/2023/09/Registar_Septemvri-2023_2.pdf) [accessed at 08.10.2023].

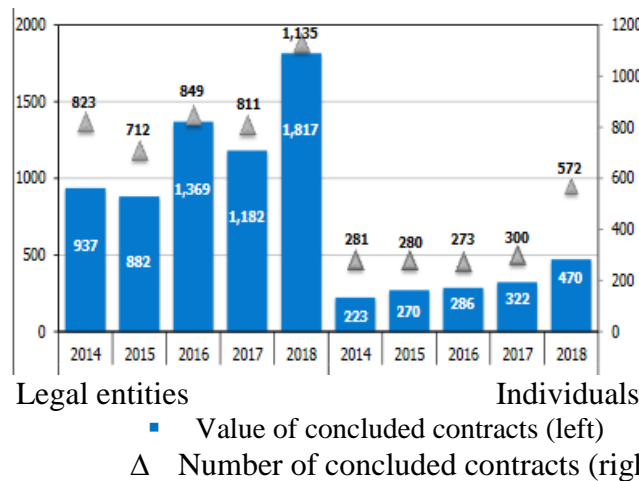
<sup>18</sup> Financial Stability Report in the Republic of Macedonia in 2018, National Bank of the Republic of North Macedonia, Skopje, 2019, 143.



**Chart 1** – Total assets and number of leasing companies

*Source: Ministry of Finance*

In 2018, the number of leasing companies increased by one company compared to the previous year and is seven. The total assets of leasing companies in 2018 recorded a fairly high growth of MKD 982 million, or 24.9% (19.9% in 2017). The total receivables of the companies based on financial leasing are about 3 times higher compared to the share capital and reserves (the legal maximum for this ratio is 10 times), which means that according to the regulations these companies have more room to grow their activities.



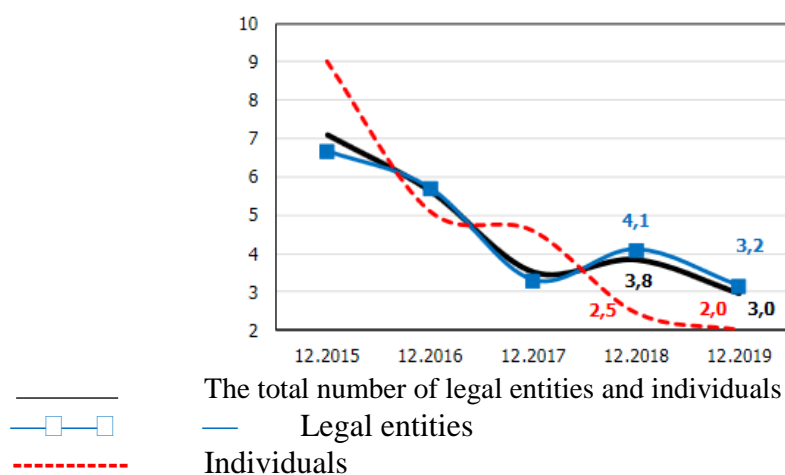
**Chart 2** – Number and value of newly concluded lease contracts (in millions of MKD)

*Source: Ministry of Finance*

In conditions of several times increase in the short-term liabilities of leasing companies, the liquidity indicators show a certain decrease in 2018. Thus, in 2018, the ratio between short-term assets and short-term liabilities of leasing companies is 1.9 (compared to 7.5 at the end of 2017). The most liquid part of the assets of the leasing sector (cash and cash equivalents) is 2.7% of total assets (2.9% on 31.12.2017) and 26.2% of short-term liabilities (112% on 31.12.2017).<sup>19</sup> In 2019, leasing companies continued to grow at a solid double-digit annual growth rate, albeit at a slower pace than the previous year. Despite the strong growth in the last three years, the leasing sector has remained relatively underdeveloped, mostly oriented towards vehicle leasing. The leasing sector has certain types of connections with other segments of the financial system,

<sup>19</sup> Ibid, 145.

but risks to financial stability are not expected, given the relatively small size of this sector. In addition, the debt of households and the corporate sector to leasing companies is very small relative to the total debt of these two sectors at an aggregate level, although the risk of over-indebtedness of individuals and legal entities is certainly present.<sup>20</sup> Furthermore, in 2019, the assets of leasing companies continued to grow, but at a slower pace compared to the previous year. Namely, in 2019, the assets of the leasing companies increased by MKD 703 million or by 14.3%, which is a weaker achievement compared to the growth of assets in 2018 (MKD 982 million or 24.9%). Unlike the previous year, when a new leasing company was established, in 2019 the number of companies operating on the market remained unchanged (7). Although the activities of leasing companies slowed down in 2019, the annual growth rate is solid and double-digit and, if the pandemic of the new coronavirus had not occurred in early 2020, it could be freely concluded that the saturation period is constantly decreasing segment of the financial system, present from 2012-2016, is already past. However, the relative underdevelopment of the leasing sector remains, which is mostly oriented towards vehicle leasing (passenger or freight), with rudimentary development of machinery and equipment leasing and undeveloped real estate leasing in general.<sup>21</sup> The growth of the companies' activities in 2019 was based on increasing the value of concluded lease contracts, both with individuals and legal entities. The value of active lease contracts concluded with natural persons increased by MKD 155 million, or by 13.1%, while lease contracts with legal entities increased by MKD 635 million, or by 12.6%. The legal entities have the largest share in the portfolio of lease contracts, accounting for 80.9% of the total value of active lease contracts.



**Chart 3** – Participation in active lease contracts with uncollected clients on any basis longer than 90 days, calculated from the due date, in the total value of active lease contracts

*Source: National Bank calculations based on data submitted by the Ministry of Finance*

What needs to be emphasized in this case, is that the cost of impairment of lease contracts in the income statements of leasing companies is very high and in 2019 it accounts for 9.4% of the total profit of the companies. Indirect exposure to credit risk, which arises from the presence of lease contracts with currency component is significant, given the fact that 99.2% of active lease contracts these companies are with MKD currency clause (in lease contracts legal entities, participation in contracts in MKD with foreign exchange clause is 99.8%, while for individuals this share is 96.3%).<sup>22</sup>

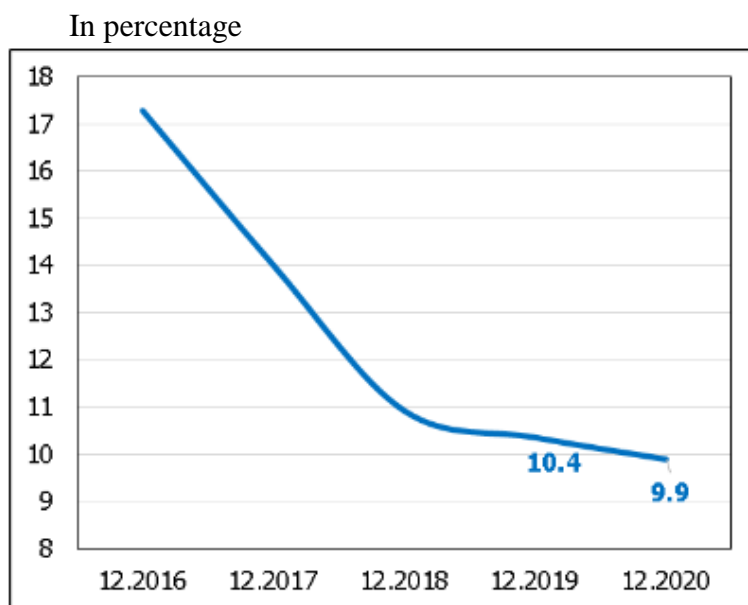
In 2020, leasing companies' liquidity ratios improved, while the capitalization rate decreased due to the faster growth of their activities. Leasing companies maintain a high short currency

<sup>20</sup> *Financial Stability Report in the Republic of Macedonia in 2019*, National Bank of the Republic of North Macedonia, Skopje, 2020, 198.

<sup>21</sup> *Ibid*, 199.

<sup>22</sup> *Ibid*, 203.

position, and almost all lease agreements are in MKD with a foreign exchange clause, which underlines the importance of the policy of de facto peg of the MKD to the euro for the stability of these institutions, which has been successfully implemented over the years. Amid the pandemic and economic crisis, the indicators of exposure to credit risk, as the most significant risk for the leasing companies deteriorated in 2020. Despite the significant increase in impairment costs of lease agreements, leasing companies have improved their profitability.<sup>23</sup>



**Chart 4** – Equity and reserves to total assets ratio

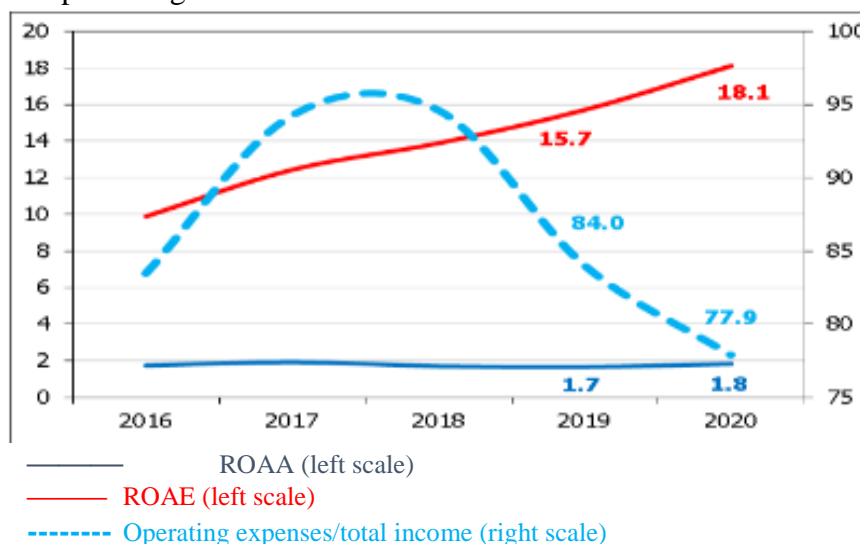
*Source: National Bank calculations based on data submitted by the Ministry of Finance*

The capitalization ratio of leasing companies, as equity and reserves to total assets ratio, decreases (by half a percentage point), compared to 2019, mainly due to the faster growth of assets (11.3%), compared to the growth of equity and reserves (6.3%). In 2020, about 45% of the 2019 profit was retained in equity and reserves of the leasing companies, where, although higher compared to the previous year (when about 30% of the profit was retained in equity and reserves), the capitalization rate of the leasing sector is declining, even at this level of reinvestment of profits.<sup>24</sup>

<sup>23</sup> *Financial Stability Report in the Republic of Macedonia in 2020*, National Bank of the Republic of North Macedonia, Skopje, 2021, 93.

<sup>24</sup> *Ibid*, 94.

In percentage



**Chart 5** – Selected profitability indicators

*Source:* National Bank calculations based on data submitted by the Ministry of Finance

The leasing companies' profitability ratios improved in 2020. The sharper decline in operating costs of leasing companies, compared to the decrease in total income and the growth of impairment costs generated higher profits for 2020 and subsequently improved profitability ratios.<sup>25</sup>

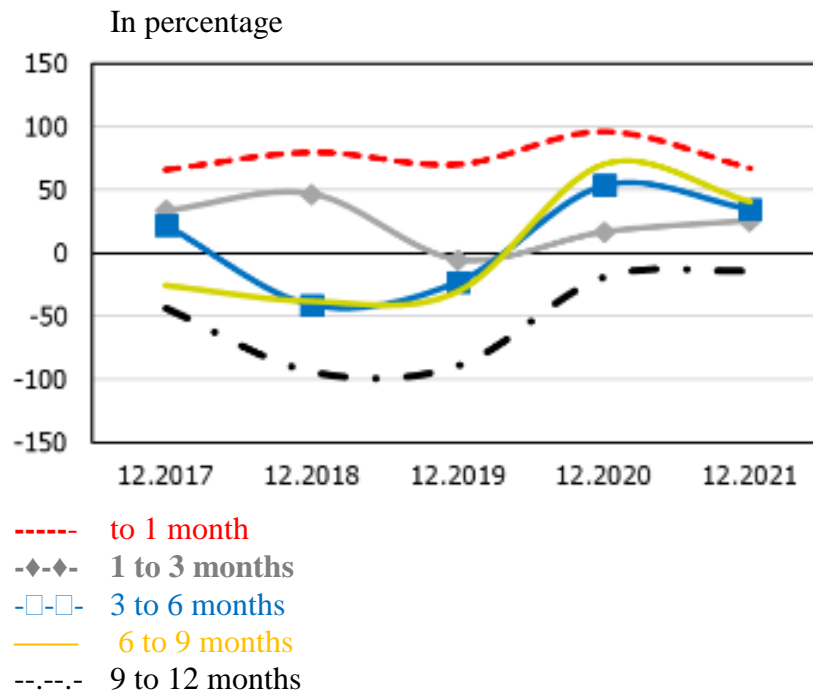
In 2021, the leasing companies continued to grow, but at a slower pace compared to the previous year. The credit risk is the most important risk in the operation of these companies, while most credit risk indicators improved in 2021. However, despite the low and declining share of active lease agreements with non-performing status (where the delay of repayment is longer than 90 days), still, a fair part of the portfolio of lease agreements is paid with certain time delay. Thus, amid still high uncertainty about the duration of the pandemic and the economic consequences, the consequences on the quality of the leasing credit portfolio are also uncertain. Namely, the deteriorated environment for all market participants, including leasing companies, as a result of the pandemic, and amid a further complicated environment due to the energy crisis, price pressures and expectations for slower economic growth, will probably cause increased materialization of the credit risk exposure in the following period.<sup>26</sup>

During 2021, the coverage of short-term liabilities with short-term assets reduced, potentially exposing the leasing sector to a higher level of liquidity risk. Thus, the liabilities with original maturity up to one year exceed the assets with original maturity up to one year, for more than 50%, while in 2020 these liabilities were covered threefold with assets with original maturity up to one year.<sup>27</sup>

<sup>25</sup> Ibid, 96.

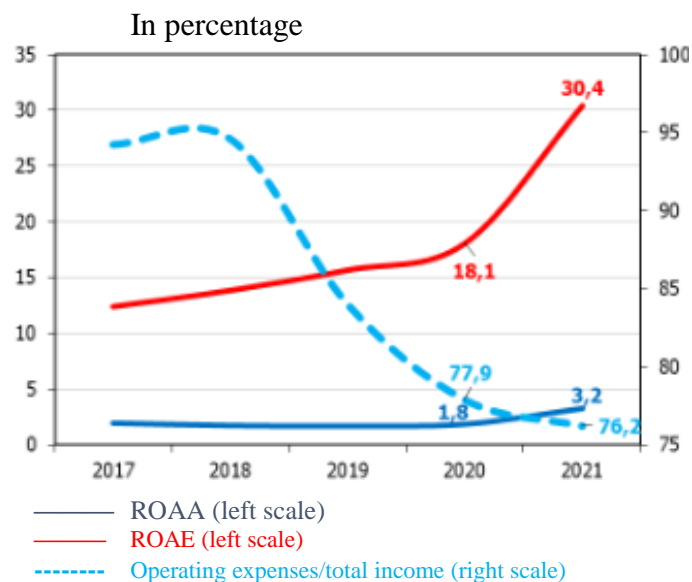
<sup>26</sup> *Financial Stability Report in the Republic of Macedonia in 2021*, National Bank of the Republic of North Macedonia, Skopje, 2022, 116.

<sup>27</sup> Ibid, 117.



**Chart 6** – Financial asset/liability gap to total financial assets, by maturity bucket, according to the contractual residual maturity  
*Source: National Bank calculations based on data submitted by the Ministry of Finance*

The leasing companies' profitability ratios improved in 2021 as well. The higher profit, compared to the previous year, was conditioned by the higher growth of total income compared to the growth of operating costs. The growth of income mostly results from the actual write-off of loan liabilities in one company, with certain contribution of the net interest income and operating leasing income.<sup>28</sup>



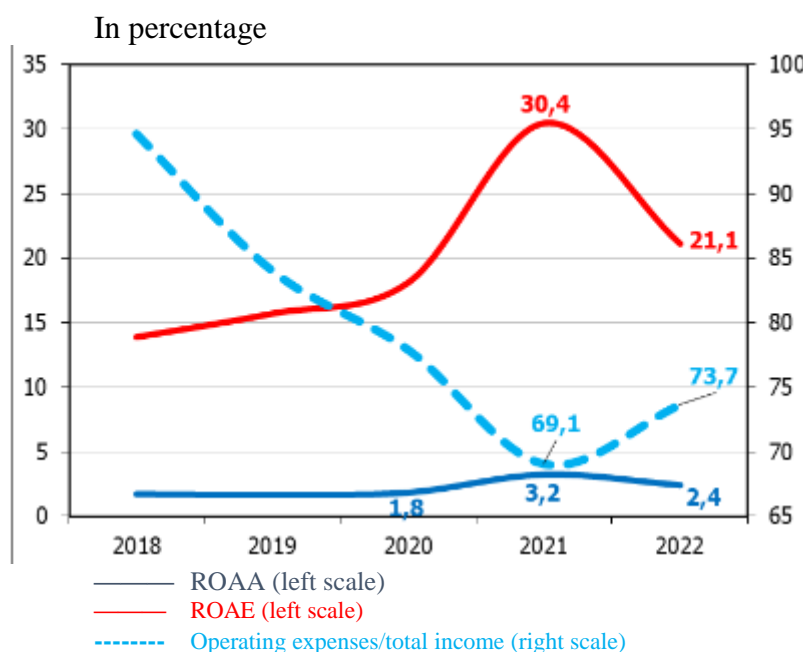
**Chart 7** – Selected profitability indicators  
*Source: National Bank calculations based on data submitted by the Ministry of Finance*

In 2022, the assets of the leasing companies continue to grow, and that accelerated compared to the previous year. Credit risk is the most significant risk in the operation of these companies,

<sup>28</sup> Ibid, 119.



and credit risk indicators show an improvement in 2022. The indicators for exposure to liquidity risk, as well as the capitalization rate, have also improved.<sup>29</sup> Indicators for the profitability of leasing companies recorded a deterioration in 2022, but they are still solid. The lower net profit compared to the previous year was conditioned by the lower growth of total revenues (which increased by MKD 8 million, or 1% compared to the growth of MKD 142 million, or 20.2% in 2021). The accelerated growth of operating expenses (MKD 45 million, or 7.7% in 2022 versus MKD 36 million, or 6.6% in 2021) also contributed to the lower profit, but also caused the deterioration of the operational efficiency of the leasing companies.<sup>30</sup>



**Chart 8** – Selected profitability indicators

*Source: National Bank calculations based on data submitted by the Ministry of Finance*

#### 4. Conclusion

The impact of the leasing sector on the financial system of the Republic of North Macedonia remains small and insignificant. With a relatively modest volume of funds and reduced volume of activities, as well as minimal cross-sectoral connection, the importance of this sector for the overall financial stability in the country is of a negligible level. A modest contribution is turning out to be the frequent change in the legal provisions of leasing, which aims to facilitate the use of leasing, to promote the leasing activity as much as possible to individuals and companies, but also to increase the reliability of customers in this activity. Leasing companies, which started as one of the fastest-growing segments of the financial system, failed to become a complement to bank lending, not increasing in significant numbers and constantly remaining in the single digits. The above research argues that the five years, despite the tendencies of recovery of the overall financial system, the leasing sector continued to feel the negative consequences of the global financial crisis, the damaging consequences of the COVID-19 pandemic, the damaging consequences of the Covid-19 pandemic, complemented by the effects of changes in legislation that allowed greater imports of used vehicles. The research provides evidence that leasing continues to have a small role and importance for the internal financial system, not constituting a channel for the flow of risks to other segments of the financial system, as well as due to the small volume and due to the weak connection with other segments of the financial system.

<sup>29</sup> *Financial Stability Report in the Republic of Macedonia in 2022*, National Bank of the Republic of North Macedonia, Skopje, 2023, 137.

<sup>30</sup> *Ibid*, 140.

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