Vendor programs: helping the equipment finance industry face the challenge of higher inflation and rising interest rates

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RISKS TO FINANCIAL STABILITY are growing rapidly as rising inflation and fragmentation risks test the adaptive capacities of the global financial system. Rising inflation and interest rates are putting the international financial system to the test.

Bank supervision was significantly strengthened after the global financial crisis, including requiring banks to hold more capital and liquid assets and to undergo stress testing to ensure their resilience to shocks.

However, the international financial system is under great strain, given that rising interest rates are shaking confidence in certain institutions. The failures of Silicon Valley Bank and Signature Bank in the US can be attributed to the flight of uninsured depositors who realised that high interest rates had caused heavy losses in the securities portfolios of these banks.

Additionally, the takeover of the Credit Suisse bank by its competitor UBS, an operation supported by the state, undermined market confidence, and triggered vast emergency responses from the authorities. In this dynamic landscape of financial strategy, innovative solutions that streamline operations, enhance efficiency, and maximise benefits are paramount to limit risks.

The equipment financing industry is tenacious and highly entrepreneurial. It has demonstrated that it is capable of adjusting to and thriving in a variety of business environments, including recessions, times of high unemployment, and even a global pandemic.

If industry executives carefully plan for impending changes and modify their operations accordingly, the equipment finance sector should be able to absorb rising inflation and interest rates. Furthermore, several factors may increase the demand for financing in the short run, including strong equipment demand and favourable lease-versus-buy conditions.

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In this article, we explore the importance and advantages of vendor leasing programs in the context of higher interest rate and inflation, and how they could propel equipment finance firms to continue their streak of innovation during this uncertain time.

- What are the different leasing business models?
- How does the vendor leasing program work?
- How is this model a win-win for lessors, lessees, vendors,

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equipment suppliers, and an effective approach to face higher interest rates and inflation?

The different leasing business models. Direct: This involves the lessor's salaried sales staff initiating transactions directly. Transactions are carried out both in-person and through tele-sales or telemarketing.

Indirect: This strategy involves employing third parties, such as brokers or packagers, to bring in transactions. In nations with a large landmass, where it's impractical to have sales representatives in every significant location, third parties, particularly brokers, are increasingly popular.

Vendor: This model involves a producer, merchant, or distributor who is essentially the seller of the goods. They originate lease financing transactions through their finance subsidiary, or enters into an alliance with a third-party lessor, providing the lessor with a steady source of volume.

The vendor program leasing model. Vendor leasing is often referred to as 'sales support leasing' and can be divided into three types:

- Lease done by the captives: In this scenario, the vendor establishes a wholly owned subsidiary to provide lease finance. Typically, a captive company leases products manufactured by the parent company or sold by resellers. However, many captive companies have strategically diversified into rental products made by others.
- Third-party leasing: This is when the seller chooses to lease the product to the customer through an independent third-party leasing company, which can be a bank or a privately-owned company.
- Lessor-vendor agreement: In this model, the lessor forms strategic partnerships with various vendor (third party partners). These vendors are typically suppliers, brokers, or providers of specific equipment or assets. In cases where the vendor is also the supplier of the asset or works with other suppliers, and a bank serves as the lessor, the asset's life cycle management leasing can be structured as follows:

Lease origination: The vendor (the leasing partner) collaborates with the lessee and the bank to structure the lease agreement that will exist between the lessor and the lessee. This can be with or without white labeling. The entire process of the credit decision is made via the risk department of the lessor and is based on the risk profile of the lessee.

Lease agreement signing: Once the lease terms are agreed upon, a lease agreement is signed by the lessee and the lessor (the bank). This agreement outlines the terms of the lease, including the lease period and payment schedule.

Asset delivery: The asset is delivered to the lessee by the vendor (which can be also the supplier). The lessee may be responsible for any initial setup or customisation of the asset, or this responsibility can be shared with the vendor.

Asset maintenance and servicing: Since the vendor is usually the supplier or the manufacturer, they are well-equipped to provide maintenance and servicing throughout the lease term.

Lease payments: The lessee makes regular lease payments to the lessor (the bank) as per the terms of the lease agreement.

Asset management and tracking: Throughout the lease term, the vendor and the lessor (the bank) may work together to track the asset's performance and condition. This can involve monitoring its usage, maintenance needs, and any necessary upgrades or replacements.

End of lease term: At the end of the lease term, the lessee has the option to return the asset, purchase it at a predetermined price (if it is a finance lease), or extend the lease.

- Contract extension: The lease agreement may include terms for automatic contract extensions, allowing the lessee to extend the lease term.
- Asset return or purchase: If the lessee chooses to return the asset, the vendor (manufacturer) can inspect and refurbish the asset if needed, or the lessee can decide to purchase the asset.
- Asset resale or re-leasing: If the asset is returned to the vendor, they can choose to resell it or enter into a new lease agreement with another customer. The bank can also finance the purchase of the asset by the vendor if necessary.

The synergy between the vendor (supplier), the lessor (bank), and any other partners involved in the transaction ensures a comprehensive and collaborative approach to asset management and leasing, accommodating various aspects of the lease agreement.

What are the benefits of the leasing vendor program? Vendor leasing is a win-win-win as it offers a multitude of benefits to all three parties – the vendor, the lessor, and the lessee.

Benefits for the lessor: Vendor leasing programs are an important source of originations for a good reason – they provide the lessor with a host of benefits, as listed below:

1. New distribution channel. Transactions originated through vendor programs create a new distribution channel for lessors who rely solely on their direct and/or third-party sales force to generate new business activities.
2. Reliable source of new business. Vendors are in the business of selling equipment. The financing needed for this results in a steady and reliable source of new business volume for the lessor.
3. Leverage the partner's sales force. The lessor relies on the partner's sales force to introduce business; or, as usual, the rental application is submitted online by the partner's customer.

   The lessor's sales team has two key responsibilities:

- One or two key individuals will liaise with the vendor's sales force team leader and the lessor's sales staff will close the referred deals.
- The real leverage comes from the lessor not having to solicit leads, an extremely time-consuming task.

In small markets and micro markets, where transactions are often seamless, online applications submitted with a wealth of financial, business and other data will save even more time from a credit approval perspective.

Reduced business costs. Having fewer sales staff, standardised operating processes, benefiting from economies of scale in processing, and simplified credit processes result in lower costs.

Enhanced profitability. Point-of-sale financing offers significant advantages to the vendor's customers. This service-oriented approach allows for competitive rates that do not necessarily have to be as low as those required when lessors directly compete with one another in terms of originated volume. When coupled with increased sales and reduced expenses, this results in improved profitability.

> *"Point-of-sale financing offers significant advantages to the vendor's customers."*

Risk sharing with the vendor. The lessor has the ability to engage in various arrangements with the vendor to jointly manage a range of risks.

Debt guarantees: The vendor can offer debt guarantees to the bank or lessor. This means that in the event the lessee defaults on their lease payments, the vendor is willing to assume responsibility for the outstanding debt. This provides a level of financial security for the bank, reducing their risk in the leasing arrangement.

Purchase guarantees: The vendor can provide purchase guarantees to the lessee. These guarantees can ensure that the lessee

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has the option to purchase the asset at a predetermined price at the end of the lease term, even if the asset's market value has changed. This can be particularly attractive to lessees who anticipate wanting to own the asset at the end of the lease.

Funding guarantees: This can enhance the lessor's ability to secure favourable financing terms and lower interest rates, benefiting the lessee.

Benefits for vendors/partners: Reliable financial source. Alliances with reliable and financially stable lessors will provide sellers with a dependable source of financing.

No debt, no carrying of receivables. Equipment sales are facilitated without any receivables associated with such sales. The risk of default leading to net losses will be borne by the lessor.

"The equipment financing industry is tenacious and highly entrepreneurial."

Better cash management. The seller is usually paid when the customer signs delivery or within a few days, depending on how the program agreement is negotiated between the two parties.

This results in improved cash flow, as the terms offered by the lessor may be better than the commercial terms offered to the customer.

Volume up, increase sales. As noted earlier in this chapter, supporting rental sales, especially through a formal vendor rental program from a trusted rental company, will help increase sales.

Higher gross profit margin. Again, as noted earlier, leasing makes the purchase price less visible; and it is a clear fact that sellers can achieve higher gross profit margins through maintaining selling prices.

Transaction control. Asset lifecycle management allows sellers to take advantage of various profit opportunities during the lease term as well as at lease termination.

Increase customer loyalty. Vendors maintain contact with their customers throughout the lease term, and vendor leasing programs are service-based. Both of these lead to increased customer loyalty.

Salary increase for sales representatives, sales commissions. Through increased sales, the supplier's sales force can earn higher commissions, leading to a more satisfied team with lower revenue.

Customer benefits: Point-of-sale financing. Instant financing at the point of sale provides a seamless, hassle-free experience.

Competitive price. Despite the earlier mention of the ability of lessors to charge higher rates for supplier-led transactions, rates are still very competitive due to the intense competition involved in securing such programs.

Lower interest rate. The vendor program utilises various possibilities to share costs. This includes the vendor's participation to share the interest rate, reduce costs, and lower service costs at the unique point of sale, providing benefit for a guaranteed purchase with the involvement of both parties.

How can we leverage vendor leasing programs: seizing opportunities in the equipment finance industry amid increased uncertainty, rate increase, and inflation? In an environment of rising interest rates and increased uncertainty, innovative new products and agreements become necessary.

Historically, during periods of high inflation and rising interest rates, equipment finance companies have introduced financing products tailored to individual risk profiles and inflation expectations.

These innovative products may include floating-rate, float-plus-fixed, or fixed-and-then-float products, allowing interest rates to reset after a given period. Alternatively, additional innovative products may be explored using the advantages of the vendor program, building new agreement terms to increase the usage of on interest sharing between lessees and vendors to mitigate interest rate growth and its impact on end users and inflation.

This drives business growth without significantly impacting global risk. Another approach is sharing the revenues of extension between partner and lessor and decrease the customer costs.

Expanding the range of available financing products within the vendor program demonstrates adaptability to changing financial conditions, fostering goodwill and encouraging repeat business.

In conclusion, amidst high inflation and rising interest rates, the equipment finance industry stands at a critical point. Collaborative strategies and innovative solutions are essential to address financial uncertainty. The potential of vendor leasing programs, combined with strategic partnerships and forward-thinking decisions, could position the equipment finance industry to proactively address current market challenges.

By adopting an adaptive approach and employing the right business solutions, including technological advancements (such as selecting the appropriate leasing software), the industry can continue on its path of resilience, providing vital financial support and boosting the economy, even in these volatile times.

Fortunately, such software exists, with iMX Leasing being one example. Though they are not so many, these software options are available, but they are available, and they continually improve with richer and more robust features through heavy investment by their respective editors over the years. We strongly encourage you to explore how the iMX Leasing solution can be the software you need in the specific context of your company and the challenges it faces.

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