EQUIPMENT LEASING & FINANCE
FOUNDATION
Your Eye On The Future

Captive Finance Firms in a Challenging Economy

Facing the Wave

The Foundation is the only research organization dedicated solely to the equipment finance industry.

The Foundation accomplishes its mission through development of future-focused studies and reports identifying critical issues that could impact the industry.

The Foundation research is independent, predictive and peer-reviewed by industry experts. The Foundation is funded solely through contributions. Contributions to the Foundation are tax deductible.

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Preface

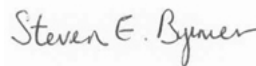
Recent traumatic recession related effects on the equipment finance industry are resulting in unprecedented changes in the environment Captives operate. Business models, once proven to be effective, are being questioned and modified. The changing market landscape has demonstrated a great degree of disparity in the value Captives are delivering to their Parent organizations.

The ***Captive Finance Firms in a Challenging Economy: Facing the Wave*** study is the latest of a series of forward looking publications the **Equipment Leasing & Finance Foundation** (The Foundation) undertook as part of its continuing effort to bring new information to the industry. This study focuses on:

- Captive evolution
- Captive strategy and operating model
- Captive dependence / independence from its Parent
- Current events' affect on Captives
- Captive measures of success

The Foundation engaged Capgemini, a leading global consulting firm, to research and produce this study for the industry. The study is based on industry research and responses from many leading Captive organizations across a large spectrum of ticket sizes, market approaches and geographies. Participation in the study was voluntary and free of charge. A total of 18 companies took time from their daily operations to contribute to the study by completing a 50-question survey designed to gather important information about the current state of the Captive market place and the relationships between Captives and their Parents.

The Foundation and Capgemini would like to thank those companies that participated in the study. Without their support and the support of industry organizations like the Foundation, this study would not have been possible.



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Executive Summary

In good times, strengths and weaknesses of a business model are often overlooked. In bad times, as with the current global recession, weaknesses often come to the forefront. For Captive Finance Companies ("Captives")[1] this is the case. Recent tightening of credit has raised concerns over access to capital and credit quality issues, calling the "true Captive" business model into question.[2]

The responses to the survey associated with the ***Captive Finance Firms in a Challenging Economy: Facing the Wave*** study and supporting research suggest that Captives need to propel through current economic wave by concentrating on the basics and:

- Focusing on financing core Parent product
- Strengthening customer relationships

Captives also need to encourage activities that are essential to ensure they are ready to tackle the next wave head on by:

- Diversifying their approach to funding and access to capital
- Developing a core competency of strong asset management capabilities
- Examining measures of success

Focusing on Core Parent Product

While some Captives have remained focused on financing their Parent's core business product, others have expanded beyond their initial product offerings to leverage their expertise and easy access to capital, creating a diversified business strategy. Over the years, some of the diversified Captives were very successful and experienced impressive growth with a dividend payout ratio[3] of over 50%. Unfortunately, the credit crisis highlighted some of the risks associated with a diversified business strategy and one of the risks for any finance company's business model: a need for regular access to stable and competitively priced sources of financing. Additionally, rapid asset growth has had, in some cases, a negative impact on the market valuation of their

[1] A Captive is defined as a company or business unit owned by the Parent, formed to provide financing to dealer networks or customers of the Parent's products that maintains an on-balance sheet portfolio of finance transactions.

[2] Fitch Ratings (2009, 07-31). *Capturing the Captives: A comparative Review of North American Captive Finance Companies*. Fitch Inc.

[3] The percentage of earnings paid to shareholders in dividends.

respective parent companies' stock due to the perception of capital, liquidity, earnings and risk issues.

Until recently, Captives were aided by their Parent's brand name and had access to relatively inexpensive capital. However, as the credit markets began to restrict the availability of any financing in mid-2007 and throughout 2008, some Parents had to contribute capital into their Captive organizations and the long-term profitability of these businesses had, in some cases, reduced. As a result, a number of Captives are "returning to the basics" of the financing of core Parent products while the Parent organizations are reexamining the effect of owning a Captive.

Strengthening Customer Relationships

A key driver in the establishment of the Captive is customer retention and value creation for the customer. A subjective goal of the Captive is to build brand loyalty and enhance the customer experience through the financing of equipment, i.e. strengthen the customer relationship. Unlike banks or independent finance providers, a Captive has a vested interest in maintaining a positive relationship with the customer because that relationship may affect the customer's decision to make future purchases of the Parent's product. With on-going customer contact through invoices and customer service, there is an opportunity to provide details on new products and be the "go-to" resource when an upgraded product is needed to increase capacity or replace obsolete technology. In addition, there is an opportunity to share information with the Parent on customer behavior. The Parent, through the end of term negotiations as well as general customer service requests, may glean insight into customer behavior, which competitors do not have. This can help shape new product offerings both for the physical product and the financial offering. In turn, this may create a competitive advantage and take some of the pressure off competing on price alone.

Diversifying the Approach to Funding and Access to Capital

Recent events have disrupted the financial markets. Captives are increasingly looking at ways to creatively find funding options to diversify their access to capital. Captives, reliant on the capital markets to meet funding obligations, are finding it is more difficult to obtain capital at an economical rate. Meanwhile, Captives that took advantage of various government programs are beginning to see an end to those programs. Captives need to reduce their exposure to single source options, especially those that were most affected by this current recession and develop a forward looking strategy focused on

a collection of funding options, which provide cost competitive rates and offer better liquidity.

Developing a Core Competency of Strong Asset Management Capabilities

Historically, Captives have lagged behind industry competitors in most aspects of operating efficiencies. The current economic climate is pushing companies to focus on efficiencies in a way Captives have not had to do in the past. On the front-end, Captives must look at integrating credit underwriting processes with a greater understanding of assets and residuals as a cornerstone to their asset management capabilities. There should be greater emphasis on working with the sales team in the prequalification stage to ensure that increased risk is matched with a premium rate. Post-booking should have an increased emphasis on mid-term upgrades and trade-ins to take advantage of the Parent's product offerings and balance the price and availability of products in the secondary market. This continues into end of term negotiations where fair market values, inventory levels, as well as residual values can all affect the Captive's financial position. Captives naturally have special or inside information about the market, which is not widely known because of their close relationship with the Parent. Captives should be leveraging this information to make full use of their product offerings and asset placement capabilities.

Examining Measures of Success

Historically, Parents have measured Captives in ways that promote a standalone business division view. Some of these traditional views of Captives are highly relevant; however, they are often benchmarked against the wrong index. Parents need to pay attention to some key metrics affecting the overall organization, but alternative approaches for evaluating success may be appropriate given the evolution of Captives (see Exhibit 1).

Exhibit 1	
Traditional Perspective	**Alternative Approach**
Diversification of financing beyond the Parent's equipment creates unnecessary risk and should be avoided. Note: There are two aspects to view—one speaks to the creation of entire business units that finance only non-Parent assets (usually in adjacent markets) and the second focuses on the mix of Parent and non-Parent equipment at a transaction level. The survey and perspectives here address the latter.	Create policies that balance Parent vs. Non-Parent financing with risk. Risk in the form of both credit and asset management related risks—e.g. increase credit requirements and decrease residual positions as the balance shifts to non-Parent equipment.
Profitability measures such as Return on Assets (ROA) and Return on Equity (ROE) are benchmarked against the Parent's returns.	Utilize ELFA benchmarking data for relevant peer Captive data and internally, create a customer lifecycle profitability measure. Acknowledge the incremental profitability driven by the Captive activity, even though it may not directly accrue to the Captive profit and loss statement.
High penetration rates (percentage of Parent's equipment financed by the Captive) and large portfolios (as a percentage of the Parent's assets) increase leverage and as a direct result, in economic times such as these, volatility.	Develop the sophistication of their treasury capabilities to become more "bank-like" in terms of asset / liability management as portfolios grow in addition to a simple leverage measure.
Underwriting standards at Captives are more lax than at banks and other finance organizations. Overall asset quality is reduced, creating exposure during an economic downturn.	Develop a core competency of strong asset management capabilities, which reduces the exposure typically associated with a weaker credit profile portfolio.

The changing economic landscape is resulting in uncertainty in the viability of some Captives leading to a degree of disparity in the real and perceived success of Captives. Heeding the current economic conditions by returning to basics, focusing on financing core Parent product and strengthening the customer relationship will prepare the Captive for the post-recession market. Meanwhile, diversifying the Captive's approach to funding and access to capital, developing a core competency of strong asset management capabilities and examining measures of success will focus the Captive on the right tasks to ensure the successful maneuvering of the next economic wave.

Introduction to Captive Finance Companies

During the expansion of the industrial revolution in the early 1900's, manufacturers in the US found they were able to sell more products by offering their own financing option for their equipment, giving birth to the Captive Finance Company ("Captive").[4] Early examples of equipment being financed include railroad and telephone equipment. Burlington Northern, AT&T, and General Electric were some of the earliest manufacturers to offer financing as a way of ensuring sales and creating a new incremental revenue stream.

Definition of a Captive

The basic definition of a Captive is a financial subsidy or division of an equipment or software manufacturer ("Parent").[5] Looking at the definition of a Captive on the internet, it is often defined as a company that has been established by a manufacturer or equipment dealer to finance the sale of its own products to end-users or lessees. When asking a number of equipment leasing and finance industry veterans for their own explanation, even more definitions emerge, such as:

> ***"A finance arm for dealers to move parent product"***
>
> ***"A program arrangement in which a third party finance company provides a private label program on the behalf of the manufacturer"***[6]
>
> ***"A financial organization where at least 60% of the lease portfolio consists of products produced by parent and/or affiliates"***[7]

Although the differences above are subtle, the key to the definitions is a manufacturer, distributor or dealer leveraging financing as a means of selling its product.

For purposes of this study, a Captive is defined as a company or business unit owned by the Parent that maintains an on-balance sheet portfolio of

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[4] A Captive is defined as a company or business unit owned by the Parent, formed to provide financing to dealer networks or customers of the Parent's products that maintains an on-balance sheet portfolio of finance transactions.

[5] Halladay, Shawn (1998). *A Guide to Equipment Leasing*. Carpediem Consulting Corporation.

[6] Equipment Leasing & Finance Foundation (2008). *A Perspective on Captive Leasing*. Equipment Leasing & Finance Foundation.

[7] Equipment Leasing & Finance Association (2009). *2009 Survey of Equipment Finance Activity*. Equipment Leasing and Finance Association.

finance transactions. A Vendor Finance Program is a program aligned with the Parent organization, but a third party owns the portfolio. While there are many hybrid versions of these two definitions, this study will limit its focus on these two alternatives.

Evolution of the Captive

A number of profiles for Captives, state that the Captive is a wholly owned subsidiary of a Parent Company, formed to provide financing to dealer networks or customers of the Parent's products. Over the years, some of the Captives experienced impressive growth with a dividend payout ratio[8] of over 50%. Eventually, easy access to capital allowed some Captives to reach beyond their initial core products. For example, General Motor Acceptance Corporation (GMAC) ventured into mortgages and Boeing Capital Corporation ventured into real estate and shipping. Textron Financial Corporation entered resort finance and structured capital, while General Electric Capital Corporation (GECC) focused on portfolio acquisitions. In time, some Captives became diversified finance companies (GECC and Textron), while others outgrew the traditional Captive model and are now a bank holding company (GMAC). While some companies expanded, others decided instead to use a Vendor Finance Program (Xerox) to manage their financial program needs.

Over time, there have been many companies that have been successful in their choice of a financing model, Captive or Vendor Finance Program. There have also been many companies that have migrated from one approach to the other – including companies that have chosen hybrid "a la carte" approaches. One example of a hybrid model is a high tech Parent that has established a Captive in one country and in another country a one-ticket size Vendor Finance Program. The key is to find the approach which works best to achieve business objectives and be flexible to change with any financing model.

Catalysts for Captive Financing

Numerous drivers have prompted the development of Captives. The primary trigger is financing expands manufacturers' or Parents' markets to businesses that do not have cash readily available or have traditionally used bank lines of credit. Additionally, customer retention, incremental income for the Parent, and value creation for the customer, have each played a critical role in the Captive financing evolution.

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[8] The percentage of earnings paid to shareholders in dividends.

Customer Retention

One driver for the existence of a Captive organization is marketing or, more precisely, customer retention. In the financial industry, a fast turnaround time is essential for retaining customers. For Captives, turnaround time is not just about winning the financing opportunity, but is also about securing the product's purchase. A delay in financing may:

- Result in the customer losing interest in the product
- Give a competitor the opportunity to convince the customer its product is better
- Allow an outside financial institution to offer a better deal

Customer retention does not end with the signing of the financing agreement. Through the use of the Captive, there is an on-going opportunity to communicate with the customer, via monthly invoices, customer service contacts and other marketing related activities. Problems can be addressed not just with the financial arrangement, but also with the product itself. If an upgraded product is needed to increase capacity or update technology there is an opportunity to deliver new products via an upgrade or rollover. Furthermore, there is an opportunity to manage the introduction of new equipment to the existing customer base.

The final aspect of customer retention comes at the end of term. The end of term notification is a key opportunity to retain the customer. Customers may be retained through the:

- Continuing use of the product via a renewal
- Purchasing of the existing product
- Financing of new a product

Although some customers may return the product at the end of term, a Captive has an advantage over other secondary market participants. Captives have the opportunity and capabilities to know the product and market better than third parties. Captives have a greater ability to forecast the resale price of used equipment, balance this price with new product prices and inventory levels, and have access to secondary market customers through its Parent.

Incremental Income for the Parent

In addition to the primary sale of the Parent's product, another reason for the development of the Captive organization is they generate additional incremental revenue and benefits. A financing transaction will typically include an interest spread between the interest earned in the transaction and the interest expense incurred on the debt used to fund the transaction. This is

deemed the financing income and is ancillary income for the Parent. The ancillary income would not have been realized if the product was purchased outright. In certain financing transactions, e.g. lease transactions, there is also a possible source of income in the residual profit, which may be recognized when the equipment is sold for more than its remaining book value at the end of the lease.

Another technique to gain additional income is to offer full service financing. This approach allows for one-stop shopping (discussed in detail in the next section). In this situation, the Captive provides the customer with the benefit of coupling the rental payment with a maintenance or supply agreement. The Captive receives additional revenue from the service agreement itself and/or from financing the service agreement. The Captive is often not responsible for the actual maintenance activities, but simply purchases the services from the Parent or a third party provider.

Captives may also see a benefit in financing equipment sold by another company. This situation occurs when related equipment is integral to the Parent's equipment to create a product bundle. Offering this type of product is another way to assist the customer in one-stop shopping because they don't have to go out and seek separate financing for each component of the product bundle. Meanwhile, the Captive may see increased sales, or avoidance of lost sales, by ensuring their product is part of the product bundle.

Value Creation

Another driver for the establishment of a Captive is the value created for the end customer. Captives enable the customer to acquire products they might have otherwise delayed or not purchased. The customer also has an opportunity to get a lower interest rate and / or payment than what is offered through traditional credit lines, as may happen when the Parent is subsidizing the low rates by foregoing some manufacturer profit. Another example of added value for the customer is a result of the Captive's confidence and knowledge of the equipment's residual value and secondary market opportunities. With this knowledge the Captive can pass on a lower interest rate, hedging against end of term knowledge.

Through the use of a lease transaction, the customer can gain the benefit of tax depreciation from a decreased tax liability. In addition, with technological advances, a Captive relationship gives customers the opportunity to hedge against out-of-date technology. By maintaining a relationship with the Captive, customers learn about the Parent's new product offering. In some cases, the customers can provide information to

the Parent through the Captive on their needs and wants, which in turn influences the products and financing offerings.

For the customer, arguably the biggest benefit for using a Captive is one-stop shopping. Customers no longer need to find the ideal product and also the financing to go along with it. While this benefit is greatest in the small ticket segment, this "convenience factor" also extends into mid-ticket, where customers are given the opportunity to reserve their bank lines for other financing requirements.

The Advent of the Vendor Finance Program

As Captives started to establish themselves in the equipment leasing and finance industry, banks and independent finance companies ("Third Party") saw an opportunity to increase their sales by encouraging equipment or manufacturer salespeople, who did not have a financial arm, to use their financing. This yielded to the development of the Vendor Finance Program. For the Third Party providing the financing there is a potential increase in application volume driven by leveraging the Parent's sales activity. Additionally, there is the opportunity to spread the same operational and overhead costs over the increased volume of transactions, providing greater cost effectiveness. Meanwhile, the Parent is able to secure the purchase of their product via new financing options and the use of their brand name.

There are times, usually coinciding with down cycles in the economy, when Parent organizations have chosen to close the doors of their Captives altogether and turn to Vendor Finance Programs as a financing alternative to satisfy the financing needs of their customers. Historically, as evidenced by acquisitions made by GE's vendor finance group in the 1990's, the reason for this has been due to the financial strength and flexibility of the Third Party. The Third Party may have:

- A better credit-rating, making the cost of funds more attractive
- Efficiencies in operations, both human and technological, which cannot be achieved at a Captive organization without substantial costs
- A proven track record with vendor finance programs, creating a seamless program which works for both parties

At the same time, the Parent frees up capital to pursue improvements in its core business, which, during an economic downturn, is often referred to as "refocusing on the core business".

A Vendor Finance Program benefits both organizations, but may best be described as a tactical approach for the Parent organization. The relationship allows the Parent to enter the financing business without an investment in the

resources, expertise and infrastructure required to have a financial arm. However, if the extent of the relationship and program is not clear, the Parent may not be able to see the benefits of having its own financing arm. For example, due to the structure of the relationship, the Parent through the Vendor Finance Program may not have the same ability to introduce new products or services to the existing customer base or new specialized financing programs. Additionally, the Parent may not have the ability to build brand loyalty with its established customer base or perform the necessary analysis on customer behavioral trends. Finally, the Parent may not be able to obtain the same benefits from the residual position and secondary equipment market since the end of term options may be controlled or influenced by the Third Party.

Amid today's credit crisis, even once stable financing companies are struggling to maintain their vendor business. Recently, Dell, Snap-On, and Microsoft made changes to their Vendor Finance Programs with CIT, at least partially due to CIT's instability and possible bankruptcy. In the case of Dell and Snap-On, the decision was made to bring the financing arm back in house. Each organization did so because they felt their balance sheet could withstand the additional leverage that a Captive division brings. Microsoft, on the other hand, has turned to other financing companies to pick up where CIT left off so they can continue to concentrate on their core business.

Recent Changes to the Captive Environment

Today, equipment financing faces challenges from multiple directions. Following global economic trends, new business volume has dropped due to the suppressed credit markets. Actual submittal of credit applications is off pace from previous years as indicated in the current MLFI 25, Monthly Leasing Finance Index and quarterly economic analysis of the industry. Of the companies showing a decline in new business volume, 60% cited lower customer demand as the main reason their new business volume declined year over year.[9] Furthermore, there is a drop in overall credit approval ratios industry wide, from 69% in FY 2007 to 62% in FY 2008.[10] Consequently, workforce levels are down at equipment finance organizations. Captives were the hardest hit with a drop in headcount nearing 9%.[11]

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[9] Equipment Leasing & Finance Association (2009). *MLFI-25.* Equipment Leasing & Finance Association.

[10] Equipment Leasing & Finance Association (2009). *2009 Survey of Equipment Finance Activity*. Equipment Leasing and Finance Association.

[11] Equipment Leasing & Finance Association (2009). *2009 Survey of Equipment Finance Activity*. Equipment Leasing and Finance Association.

Credit availability is in question not only for the customer, but also for the Captive organizations. In the years leading up to the current recession, companies chose to draw on their bank credit lines because it was better priced than what was available in the [capital] market.[12] Banks are now tightening their terms and conditions and renewing the already extended credit has become more costly.

As a result of the recent recession, portfolio quality has deteriorated. Delinquency rates have risen. The Parent's request to extend credit to customers without other credit alternatives only adds to Captives struggling portfolio quality.

On the regulatory side, proposed legislation reforms could affect Captives currently operating under minimal regulatory oversight. As the government tries to find the right balance between regulatory reform and jumpstarting the economy, Captives may be forced to change their current financing strategy or be forced to comply with compliance issues which often affect not only the Captive, but the entire Parent organization as well.

Another trend relates to the dealer networks, or third party dealers, used as distribution channels by many Parent organizations. Third party dealers are diversifying into multiple sources for financing. Captives now have to perform better analysis on who is getting what portion of the financing pie for the Parent product. They may be losing deals which were traditionally theirs. The key to this analysis is the credit mix and collateral that is going to each funding source. Maintaining a balance between offering the right incentives to dealers to ensure financing of the Parent product and the sale of the product itself, is playing a bigger role in the operating model of Captives.

This Study

The changing economic landscape is resulting in uncertainty and a degree of disparity in the success of Captives. This study uses survey responses and industry research to outline the traditional measures of success, the relevance of those measures for Captives, and provides a window into what Captives and Parents should be doing to weather the current economic wave.

A majority of the respondents to the Captive survey are Captive companies. They hold portfolios of finance transactions for their own balance sheet and are financial arms of a manufacturer. Yet, the study will give third parties who participate in Vendor Finance Programs information on how they can strengthen their relationship with the Captive to enhance their own bottom

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[12] Fitch Ratings (2009, 07-31). *Capturing the Captives: A comparative Review of North American Captive Finance Companies*. Fitch Inc.

line. Meanwhile, Captive's competitors will glean a better understanding of the challenges faced by Captives and how they can capitalize on those challenges.

Survey Findings

The Captive survey focused on four primary areas; strategy, Captive dependence / independence from the Parent, operating model and the impact of current events. The survey provided detailed insight into the following topics:

- Overall Captive strategy
- Alignment of Captive and Parent strategies
- Captive / Parent integration
- Captive funding sources
- Customer's view of the Captive
- Captive operating model
- Sales trends and product mix
- Current events' affect on Captives (covered in the next section)

One conclusion from the survey responses is that, due to the economy, Captives are reconsidering their role and refocusing their efforts back to being a conduit for selling its Parent's products. Although this means the prime directive of Captives is unchanged, it is still significant. Over the years, some Captives diversified beyond their intended scope and size, which raises the question: How big should a Captive Finance Company be?[13]

The responses and research suggest that Captives need to heed the current economic wave and return back to basics:

- Focusing on financing core Parent product
- Strengthening customer relationships

Captives also need to embrace changes that are necessary to ensure they are prepared to take the next wave head on by:

- Diversifying their approach to funding and access to capital
- Developing a core competency of strong asset management capabilities

Overall Captive Strategy

Survey respondents stated supporting the Parent's sales effort is the primary mission of the Captive, which narrowly outnumbered operating as a profitable subsidiary on a standalone basis. This correlates directly Captives'

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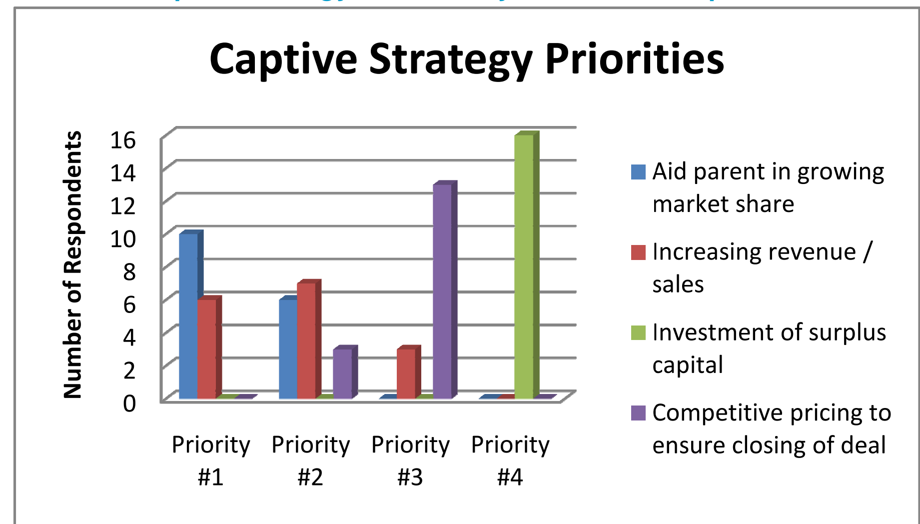
[13] Fitch Ratings (2009, 07-31). *Capturing the Captives: A comparative Review of North American Captive Finance Companies*. Fitch Inc.

mission statements to sell product while providing a satisfactory return on invested capital. All respondents listed aiding the parent in gaining market share as either the number one or number two strategic priorities (see Exhibit 2). Conversely, using the Captive as a means of investing surplus capital ranked as the lowest strategic priority across all respondents. This suggests Captives are already aware of the need to refocus on core business segments.

Exhibit 2: Captive Strategy Priorities by Number of Respondents



Captives were also asked about their strategic planning horizon. Their typical strategic planning horizon is more than two years. The more than two-year horizon allows Captives to gauge their progress and adapt to new challenges while not losing focus of their long-term goals.

Two-thirds of the respondents stated their go-to-market strategy is not expected to change in the future. Of those who did state there would be change, they provided reasons such as:

- Adapting to changing Markets
- Broadening of non-parent business
- Mergers and Acquisitions (M&A) impact

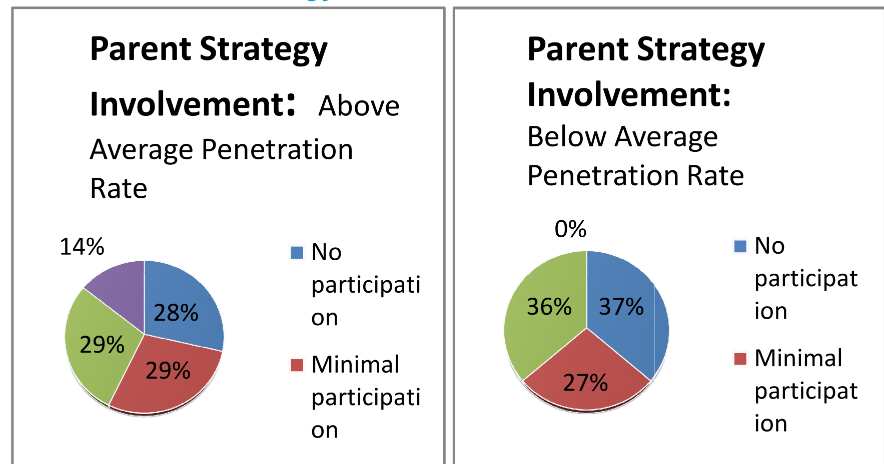
A word of caution to those who are looking at diversification as an element in their go-to-market strategy; there is a need for ongoing access to stable and competitively priced sources of financing with this approach. GECC, who contributed almost 50% to General Electric's net income in prior

years,[14] is shrinking its portfolio and focusing on core segments, at least partially because of an increased cost of capital.

Alignment of Captive and Parent Strategies

While half of the respondents said the strategic plan of the Parent has a significant effect on the Captive, only a single respondent had heavy involvement in the planning of their Parent strategy. All respondents with a higher than average Parent sales penetration[15] rate (29% was the average penetration rate) reported they had at least minimal involvement in Parent strategy. Meanwhile, a majority of respondents with a lower than average penetration rate did not participate in the Parent's strategic planning activities (see Exhibit 3).

Exhibit 3: Parent Strategy Involvement



These findings are not surprising since this integrated strategy approach can aid in driving organizational alignment. For example, the Captive can provide a financing program that highlights a product or market, thereby increasing sales penetration. In recent years, Parents and Captives have worked together to benefit both organizations. One example is the role an IT provider played in the rebuilding effort after the Hurricane Katrina disaster in 2005. The IT provider's Captive utilized data on the products financed by organizations in the hardest hit areas of the Gulf Coast to determine what was needed in the area. They were then able to provide financing which

[14] Fitch Ratings (2009, 07-31). *Capturing the Captives: A comparative Review of North American Captive Finance Companies*. Fitch Inc.

[15] Sales penetration is defined as percent of Parent sales financed through the Captive.

allowed organizations to re-open for business and keep the IT provider products embedded in the Gulf Coast region.

When asked how big of a part the Parent plays in the Captive strategy planning, 83% of the responses stated there is some level of involvement. When asked to provide details on what element of the Parent's strategy has the biggest impact on the Captive strategy the response was growth: organic, M&A, new geographies or new vertical markets.

One way to see increased organic growth is through the use of integrated systems, including a Customer Relationship Management (CRM) system. For instance, a CRM system can be set up to show available financing or incentive programs that exist for a product, or the pre-negotiated terms of a customer's master agreement. The capabilities of the CRM system enable the salesperson to create a product and financing package very quickly and with minimal effort. The speed of putting together the transaction offering should have a positive effect on turnaround time which is a key to customer retention. A fully integrated system, from sales and opportunity management to booking, can also provide a sales person with the forms needed to complete a credit application with minimal information from the customer. A fully integrated system can even give alternative pricing using configurable rate cards with varying terms and financing alternatives.

Due to the current economic environment, 67% of the respondents confirmed that the Captive's role will increase in importance within its organization as a whole. The primary reason Captive's will gain importance is that financing is now seen as a prerequisite for doing business, even with traditional cash customers. The credit crisis is forcing customers to seek out financial solutions that were once unnecessary. Meanwhile, salespeople are more receptive to finance and marketing programs as they look for more ways than just product features to close a deal.

A sampling of the quoted reasons for the Captives increase in importance within the organization as cited by the survey respondents includes:

> ***"As credit tightens in the broader market, credit capacity from the Captive becomes more relevant. Tighter financial markets limit our growth potential in non-Captive or near Captive areas"***

> ***"Since the Parent sales have decreased significantly our contribution to not only the top line but the bottom line has increased dramatically. Ways to expand Captive business is now seen as a positive move"***

"Liquidity is a differentiator in today's environment; financing is increasingly going to be a differentiator"

"Financing is often becoming a requirement of customers in order to do business with our Parent"

"Higher financing penetration will drive additional reliance on one another. New revenue stream opportunities [services] may well rely on [our] ability to deliver an all encompassing payment to the customer"

"As credit conditions remain tight, clients are coming to the Captive to finance solutions. Clients are shifting from capex (capital expenditures) to opex (operating expenditures). CFO's are increasing their involvement in the decision to purchase IT decisions"

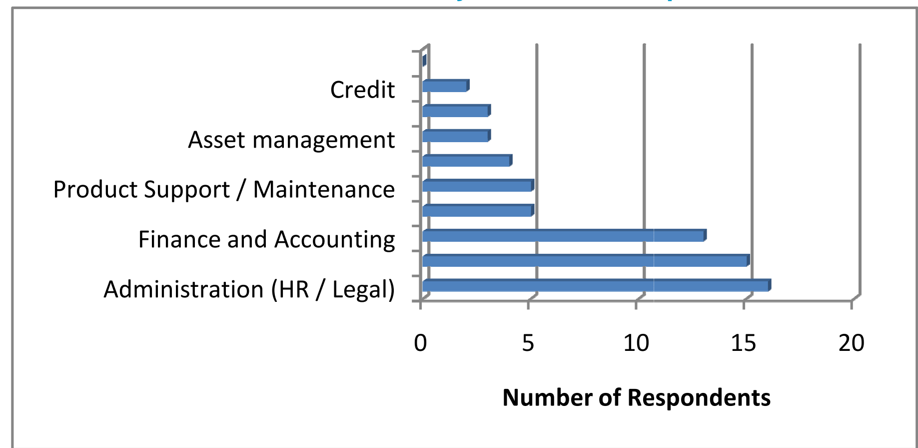
Captive / Parent Integration

Despite potential benefits, the integration of Captive systems to Parent systems is not commonplace. Seventy-one percent of respondents reported limited integration to Parent systems today. Yet 65% of respondents answered their future technology strategy will include increased integration, both for existing best of breed and Enterprise Relationship Planning (ERP) systems. The respondents indicated that the driving force for the enablement of system changes were modern technologies and legacy system upgrades.

To date, ERP software vendors have had a difficult time making their products compelling to Captives, even with the Parent being an existing customer. Luckily, with the latest technology it is still possible to integrate best of breed systems or next generation products with the Parent's ERP systems. Selecting the right solution requires an understanding of the strategy and vision of both the Captive and the Parent. No matter the approach to the integration, the benefit is a more seamless organization. A seamless organization allows for shared information and better alignment across the organizations. This creates opportunities to have consistent methodologies using common tools, processes and resources. One key advantage of a seamless organization is customer behavioral trends can be examined. When does a customer decide to purchase vs. finance? When are additional services, such as insurance, extended warranties, or maintenance consumed? These details can help to create financing products that entice the customer to purchase not just the physical product but also additional services.

Shared services across the Captive and Parent vary on a department to department basis. The most common integrated departments are: Administration (HR / Legal); IT Support; Finance and Accounting (see Exhibit 4). Less than a third of the Captive sales departments were integrated into the Parent. Tighter integration with the Parent appears to be a missed opportunity.

Exhibit 4: Shared Services Listed by Number of Respondents



Customer support, contract maintenance, and asset management are logical shared services since both organizations are supporting the same product. In the case of asset management, over 80% of Captives reported providing favorable end of term programs and 70% reported offering mid-term programs. If that is the case, why are these departments not shared services in more organizations? Certainly, the Parent can take advantage of the knowledge held within the Captive for stimulating sales. In a downtrodden economy, creating efficiencies through shared services is another way to lessen the burden on the top line.

System limitations aside, a consistent perspective among Captives is that they are "unique" and it is difficult, if not impossible to integrate a Parent with a Captive in an efficient and meaningful way. Some Captives however, are moving forward with integrations of systems, processes and resources in ways that will drive long term strategic benefits. For example, an office equipment Captive has effectively integrated a shared service call center operation with the Parent. One group efficiently manages a broad spectrum of customer service functions for the Parent and Captive. This company is anticipating further benefits to be derived as this function is moved to a low cost center. From a customer perspective this also promotes reduced

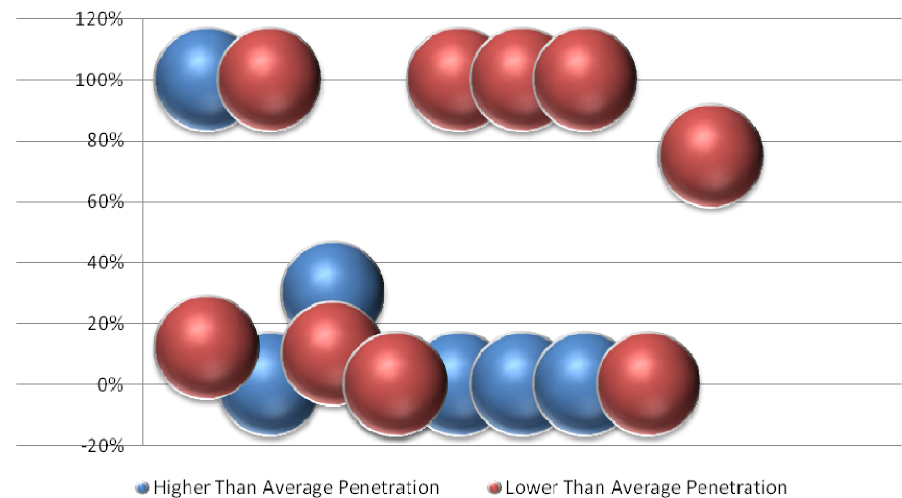
complexity and ease of doing business as the customer doesn't have to make multiple calls – a win-win situation for all parties.

Captive Funding Sources

Respondents were asked to assign a percentage of funding to four main source categories: Parent company capital, banks, financial markets, and stand alone capital structures (separate from Parent). Each of the four categories claimed at least one respondent who receives 100% funding from that one category. The Parent comes in as the largest funding source, supplying 39% of all funding. Analysis of the Parent's financials via 10K reports indicated combinations of sources are used by the Parent to fund the Captive's customers financing activity. Cash generated from operations, cash on hand, capital markets borrowings (both short and long-term), and revolving credit lines are listed as funding sources. In the survey, Banks and financial markets followed at about 25% of funding volume each. The remainder was stand alone capital structures separate from the Parent.

A trend was established regarding penetration rate: the higher the penetration rate, the less reliant the Captive is on Parent funding. Inversely, the lower the penetration rate, the more reliant the Captive is on Parent funding (see Exhibit 5).

Exhibit 5: Percentage of Parent Funding



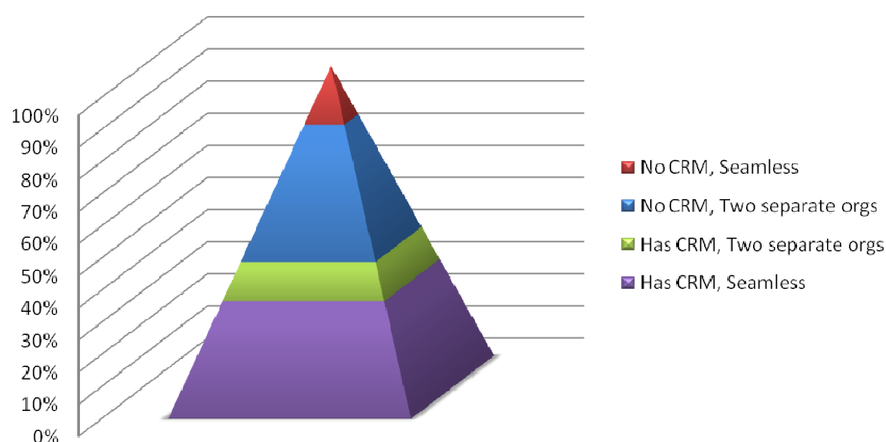
Not surprisingly, 75% of Captives expressed a need to diversify their approach to funding. The current financial crisis has disrupted the financial markets. Organizations reliant on the capital markets to meet funding

obligations are finding it harder to get capital at an economical rate. At the same time, the economy has affected the demand for funding and overall borrowing rates. Until the short-term borrowing rate improves, Captives will likely use cash generated from portfolio repayment and asset sales to satisfy short-term funding obligations. An interesting finding about the respondents who expressed a need to diversify their funding is they represent both Captives using a single source and those who already diversify into multiple categories. Therefore, from a long-term perspective, part of the initiative to diversify the approach to funding also needs to include the management of assets and liabilities and balancing the types of risks, both credit and residual, which exists within the customer base. The diversification, along with funding options with better liquidity and lower costs, will enable the Captive to handle the ups and downs of the financial market.

Customer's View of the Captive

Respondents were split when asked if the customer sees one seamless organization or two separate entities. A majority of mid-ticket respondents replied the customer sees two separate entities. However, Parents and Captives with a CRM system in place are often perceived as one seamless organization while those without a CRM are seen as two separate entities (see Exhibit 6).

Exhibit 6: CRM & Customer Perception



This suggests having a CRM system can drive an enhanced level of unity between the Captive and Parent. Although, this sense of unity may not indicate how a customer feels about either organization, it lends itself to other opportunities. Captives can refocus by adding value to the customer and improving the customer relationship. A CRM system should eliminate

the need for dual entry of data and provide better tracking of customer interaction. Eliminating redundancy frees up time and resources, which allows the customer services functions within both organizations to put the focus back on the customer. A CRM solution also enables the analysis of past customer transactions. Trends may be found in customer behavior which would allow transactions to be structured to meet the needs of the customer. Finally, a CRM systems can shed light on which products are typically financed versus purchased. This information can then be used for future sales initiatives as well as marketing campaigns.

Captive Operating Model

A peer comparison was asked to be provided with 35% of respondents stating their systems and operational capabilities were superior to industry standards. Fifty-three percent stated they meet industry standards. The reasons they noted themselves as superior were varied and included: custom pricing, programs, billing, customer service and consistent systems.

Core competencies of the Captive operating model for many companies include: point of sale, customer service and asset management. Historically, Captives have lagged behind industry competitors in most aspects of operating efficiencies. The survey respondents reiterated this historical trend since only 35% rate their capabilities superior to industry standards.

However, the current economic climate is pushing companies to focus on costs in a way Captives have not historically had to do. This suggests Captives should be re-evaluating their capabilities and searching out areas for improvement.

Respondents were also asked about how the Captive's Asset Management / End of Term (EOT) strategy aligns with the Parent's customer retention strategy (see Exhibit 7) and equipment inventory strategy (see Exhibit 8). Overall, the below two graphs show a focus on financing core segment business, but also a missed opportunity of not integrating more on asset management activities.

Exhibit 7: Asset Management / EOT Strategy Alignment with Parent's Customer Retention Strategy

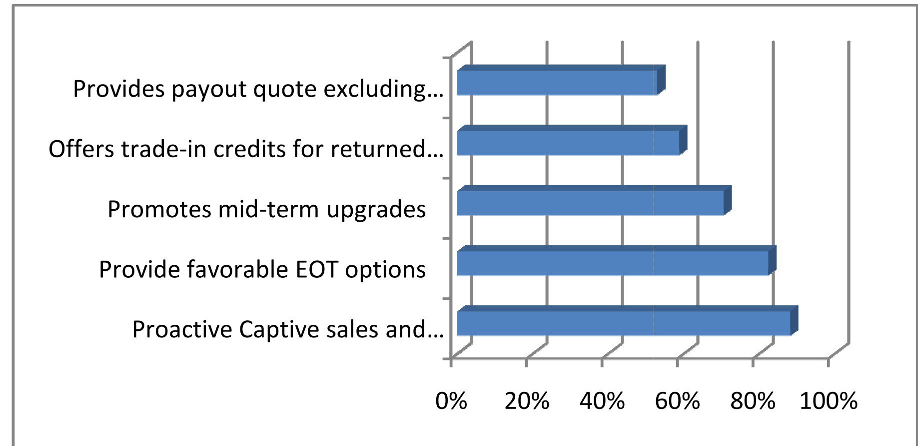
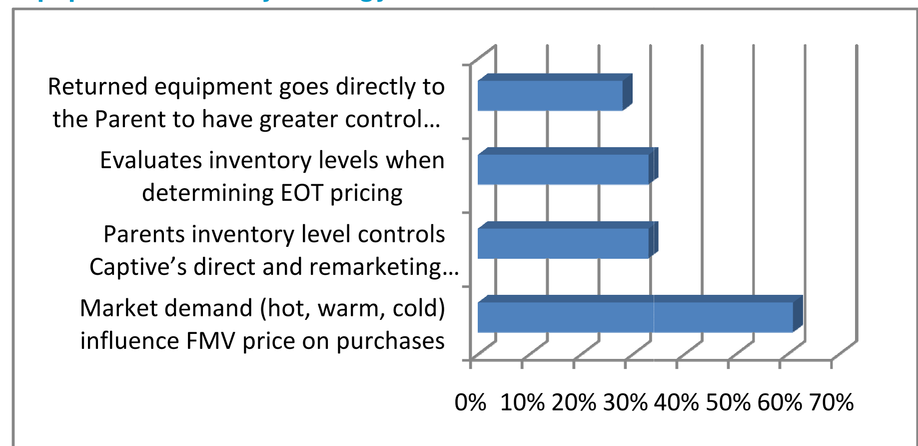


Exhibit 8: Asset Management / EOT Strategy Alignment with Parent's Equipment Inventory Strategy



Specifically, one aspect of the business model that Captives seem to be executing well is EOT strategies that can both benefit the Captive and align with the customer retention strategy. More than 50% of respondents indicated they offer trade-in credits and promote mid-term upgrades. Unfortunately, the EOT strategy doesn't transfer as well to the Parent's equipment inventory strategy. Nearly all respondents indicated market demand influences Fair Market Value (FMV) price on purchase. However, only 30% of respondents indicated inventory levels are evaluated when determining EOT pricing. This suggests Captive's are not taking full advantage of their opportunity to integrate with the product and inventory management strategies of the Parent.

Sales Trends and Product Mix

Questions were asked regarding the Captive's involvement in sales and marketing policy, direction for the Parent, and the Parent's involvement with the Captive. The responses show that Parent's sales and Captive's sales seldom close their transactions independently.

The Parent has a strong involvement on a tactical level in the Captive selling process and vice versa. Following are some examples of Captive's involvement in Parent sales and marketing efforts:

- 67% of Captives are involved in creating new financial product offerings
- 61% of Captives are involved in determining pricing packages
- 56% of Captives are involved in developing marketing materials

Switching sides, over half the time the Parent is involved with the Captive's sales and marketing efforts in:

- Creating pricing packages (bundled packages or special configurations)
- Generating new customers
- Sales calls
- Creating new financial product offerings
- Developing marketing materials

Three out of four respondents are allowed to go-to-market with third party equipment. Interestingly enough, 25% of this group reported that it is not beneficial for them to finance non-Parent products. Unfortunately, this viewpoint contradicts the customer's desire to have one-stop shopping, and the evolution to solution selling. However, this does match the industry experts who recommend staying away from financing non-Parent product because of the added risks associated with expanding beyond the core Captive's business segments. In addition, it matches the viewpoint of the Captives who cannot go-to-market with third party equipment. This suggests it is critical to create policies that balance Parent and non-Parent financing with risk. Risk in the form of both credit and asset management related risks. For instance, more Captives reported taking the approach of increasing credit requirements and decreasing residual positions as the balance shifts to non-Parent equipment.

By a two to one margin, Captives stated that the penetration rate of Parent sales is increasing. This directly correlates to the comment that respondents feel financing is often becoming a requirement of customers in order to do business with their Parent. Even with increased penetration rates, blind

discounts are still common incentives used to finance Parent products and still give Captives the opportunity to offer rates lower than competitors.

Current Events' Affect on Captives

Recently there were news and financial reports that gave glimmers of hope that the recession is over. Continued improvements in financial market conditions have allowed the U.S. Federal Reserve Bank to scale back emergency lending programs. Conditions in the housing market are improving and unemployment rates are slowing. Unfortunately, the expectation from many Captives is that the recovery from the recession and credit crisis will take some time to permeate through the equipment financing industry, especially for Captive's who are often the largest debt issuers relative to their Parent's balance sheet.

Survey Analysis

Not surprisingly, more than three-quarters of respondents felt that the recent economic turmoil has affected their business in the following ways:

- Increased delinquency rates
- Increased focus on funding options
- Downgraded portfolio quality

For example, there has been a nearly 50% increase in delinquency rates greater than 30 days between 2007 and 2009 (based on Captive's total portfolio).

In response to these key economic outcomes, respondents were asked whether the balance of risk between the Captive and Parent changed. Seventy-eight percent of respondents reported either no shift in balance or the Parent viewed the Captive as decreasing overall company risk.

In order to manage any shift in balancing risk, respondents cited two key processes requiring enhancement; 1) credit decisioning and 2) collections. The necessary improvements needed to meet these goals include:

- Refining credit scoring models
- Improving credit approval processes
- Working with the sales team on pre-qualifications
- Enhancing collections processes

Lastly, there are a number of unique approaches that Captives are using to be more effective in today's difficult market. A representative sampling of quotes follows below:

"Tighten credit criteria and create higher reserves and impairments"

"Creating new funding capabilities to address loss of finance partners to address international interests"

"Better credit decisions and tighter guidelines as well as more attention to delinquencies. Increase in our rate structures for Parent and non-Parent financing"

"Develop lines of credit to fund transactions and sell them as booked deals with funding sources outside our normal domain"

"Off-balance sheet and payment deferrals where operating budget issues exist"

"Expansion of banking relationships, entering into agreements with institutions once considered too cumbersome, increased networking of financial partners, looking for inventive ways to work with those that have existing credit lines"

"Broaden the portfolio of program investors and diversify across multiple institutional models (independent, commercial bank, specialists, etc.)"

The U.S. Macroeconomic Activity—Setting the Scene

Not unexpectedly, U.S. macroeconomic activity plays a crucial role in the state of Captives in today's challenging economy. The current global recession is well documented,[16][17] including a decline in key economic indicators such as new business volume and new equipment acquisitions. This trend directly affects investment growth, forcing companies to be cautious as they struggle to maintain healthy balance sheets.

More specifically, three factors affecting the economy acutely affect the Captive. First, demand uncertainty is a major influence on company profitability. Companies remain cautious while they manage profitability through inventory reductions and other cost-cutting measures.[18] According to Exhibit 9, lease receivables saw a drop from approximately $235 million in

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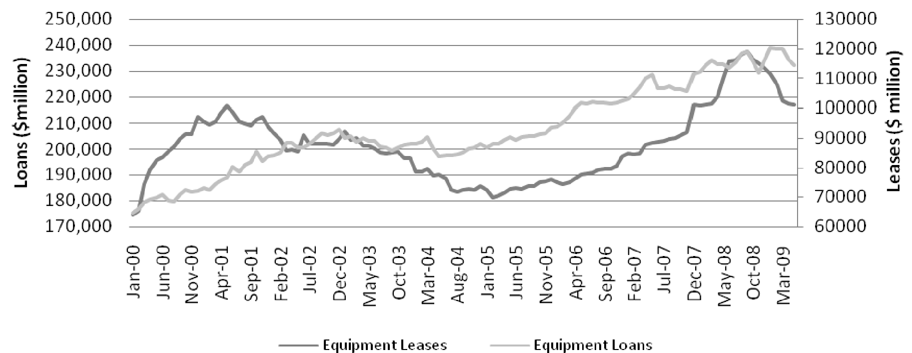
[16] Equipment Leasing & Finance Foundation Market Study 2007-2008, *Global Insight.* Equipment Leasing & Finance Foundation.

[17] International Monetary Fund (2009, July), *IMF Country Report No. 09/229.* International Monetary Fund.

[18] Wall Street Journal (2009, 8-31), *Can Rally Run Without Revenue?* Wall Street Journal.

October 2008 to $218 million in March 2009 indicating a material change during a relatively short period. According to the International Monetary Fund (IMF), aggregate demand growth will remain sluggish.[19]

Exhibit 9: Total Equipment Loan and Lease Receivables Outstanding[20]



In response, organizations such as IT providers are using their Captives to stimulate increased sales. For example, IBM's financing unit will make up to $3 billion available for the financing of technology projects in Europe and Asia[21] and Cisco is providing new financing options and increasing rebates for value added resellers. In addition, Cisco is offering a series of stimulus initiatives and financing resources to help spur sales of its core and advance technology products.[22][23] Meanwhile, Hewlett Packard is underwriting more of its customer's purchases.[24]

Second, portfolio quality deterioration is a key concern. The weakened state of portfolio quality is evidenced in Exhibit 10 wherein Loss Reserves saw a jump from $26 billion in the 3rd Quarter 2006 to nearly double at $50 billion in the 1st Quarter 2009.

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[19] International Monetary Fund (2009, July), *IMF Country Report No. 09/229.* International Monetary Fund.

[20] Aggregated Federal data (by quarter): Receivable portfolios, Equipment loans and leases (excluding motor vehicles) Jan 2000—May 2009.

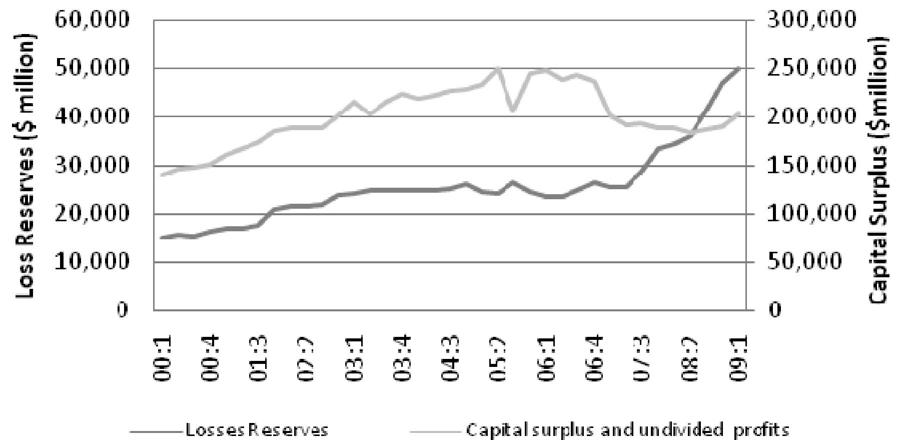
[21] Prodhan, G. (2009, 05 27). IBM earmarks $3 billion for Europe and Asia stimulus. Reuters.

[22] World Leasing News. (2009, 04-20). *Cisco UK, Ireland Launches Equipment Financing Program. World Leasing News.*

[23] Monitor Daily. (2009, 06-17). *Cisco Expands Financing Options for Global Channel Partners.* Monitor Daily.

[24] Dow Jones Newswire. (2009, 04-13). *HP Looking For New Lease On Life. Dow Jones Newswire.*

Exhibit 10: Finance Companies Loss Reserves and Capital Surpluses



These reserves began building dramatically in early 2007, showing no evidence of slowdown. This signifies these firms will continue to take large write-downs on their credit portfolios. Conversely the chart also describes finance companies' capital, surplus and undivided profits or equity. The aggregate equity of firms dropped in late 2006, dipping to levels not seen since 2001. This equity position hit a low in late 2008 and is slowly recovering primarily through slashing inventories, jobs and other costs.

Finally, regulatory uncertainty has the potential for long-term changes while as the U.S. government strives to balance regulatory reform with jumpstarting the economy. In the long-term, Captives must face the government's response to preventing a repeat performance of the worst economic decline since the Great Depression. As a result, regulators are considering "whether to make Captive finance units like GE Capital subject to the same regulations as banks".[25] In response, Captives such as Pitney Bowes said it "will work to educate Congress about their role in providing credit for commercial activity… [They think] it is important that these services continue".[26]

Specific Impacts on Captives

While a few of the survey respondents reported not being adversely affected by the current recession, the impact for the majority of the Captives focus on three key themes: an increase in delinquency rates, challenges with respect to

[25] Benner, Katie (2009, 10-10). Fortune Magazine online *General Electric comes clean.* Fortune Magazine online.

[26] Enrich, David and Side, Robin (2009, 6-19). *Corporate Lenders Get Hit.* The Wall Street Journal.

liquidity and decreases in portfolio quality. For those Captives who use a dealer network, they also have to focus on better management of the dealer network.

Delinquency Rates

The table below represents data from our survey respondents (see Exhibit 11). It shows a nearly 50% increase in delinquency rates greater than 30 days between 2007 and 2009 as stated in percent of total portfolio (2009, 2008, and 2007).

Exhibit 11		
Year	Year End Delinquency	Total Num
2009	3.3%	14
2008	2.7%	15
2007	2.4%	14

The above table is consistent with further research showing delinquency rates for commercial and industrial loans rose from 3.12% to 3.73%, while delinquencies for consumer loans rose from 4.69% to 4.92%, also a 22-year high.[27] When reviewing the past five Survey of Industry Activity reports for the distribution of Net Investment by Aging Category and Type of Organization, it is clear the economy is causing an increase in all organization's delinquency figures. However, for Captives this increase is more substantial. Using the greater than 30 day aging category as an example, Exhibit 12 displays the delinquency percent for the last five year.[28]

Exhibit 12: Greater than 30 Day Aging Category (Weighted average of the dollar distribution of receivables, shown as a percentage of total receivables, by type of organization)			
Year	Banks	Captives	Independent, Financial Services
2008	1.5%	5.8%	3.3%
2007	1.5%	3.3%	2.7%
2006	1.2%	4.7%	2.9%

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[27] http://www.marketwatch.com/story/delinquency-rate-on-bank-loans-up-to-record-649-2009-08-17.

[28] Equipment Leasing & Finance Association (2009-2005). *2009, 2008, 2007, 2006, 2005 Survey of Equipment Finance Activity.* Equipment Leasing and Finance Association.

Exhibit 12: Greater than 30 Day Aging Category (Weighted average of the dollar distribution of receivables, shown as a percentage of total receivables, by type of organization)			
Year	Banks	Captives	Independent, Financial Services
2005	1,6%	4.0%	2.1%
2004	1.4%	3.0%	1.9%

As more and more customers struggle to make payments this could lead to increased collections costs while Captives pursue borrowers for payment. Additionally, there is a potential loss of a customer to the Parent for future short-term business.

Liquidity Challenges

Captives are increasingly looking at ways to creatively find funding options to diversify their access to capital. According to Fitch ratings, "the availability of financing and the need to contribute into Captives has reduced the long-term profitability of these [Captive] businesses."[29] As capital becomes scarcer, it also becomes more expensive, in relative terms. For instance, using Parent capital to increase the Captive funding base is a very expensive way to solve a liquidity issue. Given the weak economy and increased competition, it will be difficult for Captive's to pass on these increased borrowing costs to customers and dealers.

Those who have maintained access to capital have done so though a number of means. The most notable is simply the strength of the Parent. Companies such as Caterpillar Financial and Harley-Davidson have been able to issue term debt with relative ease simply because customers have confidence in their brands. Another avenue is securitizations. Although, the securitization market was off pace in 2008 and early 2009, there is a new opportunity for securitized portfolios in the market. Thanks to the Financial Stability Plan, which is part of the Term Asset-Backed Securities Loan Facility (TALF), the U.S. Government has helped to grow interest in the securitization market again. Finally, there are companies that maintain a revolving credit agreement, which provides them with additional liquidity, if needed.

Decreasing Portfolio Quality

Increasingly Captives are faced with deteriorating customer credit quality. While Captives have attempted to combat this through more selective credit

[29] Fitch Business Wire. *Return to Basics for North American Captive Finance Companies.* Fitch Business Wire Online.

screening, there is still a significant gap between Captive and industry approval ratios. Captive's approved close to 91% of applications in 2008 versus 72% for the overall industry.[30] Credit processing for Captives is also very expensive, as Captives approved 56% of transactions (as a percentage of volume) without the use of a scorecard. Banks and independents were at 32% and 20% respectively.[31] Of course, it is possible the recession contributed to a lack of confidence in the cards and the bureau data. Therefore, many Captive companies have reported that they are ignoring scorecards and returning to manual underwriting processes. In either case there is still room for improvement, whether that be simply using scorecards or refining the scorecards to be more relevant. Of course, no matter how much Captive's improve their credit process, they usually have an opposing force working against them, the Parent. The Parent wants the Captive to provide credit to companies without other credit alternatives to move product. Therefore, Captive's credit statistics will more than likely never be in line with the industry average.

What does this mean in the short term? While the increased approvals may have a near term positive impact for the Parent, it is likely the Captive's portfolios will take longer to recover than either bank or independent finance companies will.

Dealer Network Management

Dealer networks, or third party dealers, are diversifying into multiple sources for financing. The reason for this is two-fold. First, similar to the Captive, the dealers have a need to diversify when it comes to their portfolio debt management. Second, the dealers are being offered incentives on other financing needs related to running its business For example dealers may receive a higher customer relationship rating or better rates on their own business loans for bringing the added volume of business to another source. Dealers are still originating transactions for the Captive, but they may be losing deals which were traditionally theirs. Additionally, the dealers may be selecting which transactions go to which funding source. For example, the Captive may be getting the customers with questionable credit, while the other institutions are being offered the more creditworthy customers. Captives have to do a better analysis on who is getting what portion of the financing pie for the Parent product. The key to this analysis is the credit mix and collateral that is going to each funding source. Maintaining a balance

[30] Equipment Leasing & Finance Association (2009). *2009 Survey of Equipment Finance Activity*. Equipment Leasing and Finance Association.

[31] Equipment Leasing & Finance Association (2009). *2009 Survey of Equipment Finance Activity*. Equipment Leasing and Finance Association.

between offering the right incentives to the dealers to ensure the Captive has the product financing and the sale of the product itself, is likely to play a bigger role in the operating model of Captives going forward.

Coping Strategies and the Relationship between the Parent and Captive

Despite predictions that it may take years for the economy to fully recover, some Captives are rethinking the way they do business. They are engaging in new business initiatives to strengthen their portfolios and balance sheets. Some Captives are expanding in new geographies and lines of businesses, further diversifying and building their portfolios. When questioned about how the current economic environment was affecting the Parents view of the Captive relative to the balance of risk, (Exhibit 13), the majority of respondents either reported no shift in balance or the Parent's view the Captive as decreasing overall company risk. This may be attributed to the Captive effectively managing portfolio challenges by limiting the ultimate losses associated with charge-offs through strong asset management.

Exhibit 13

Option	Number	Total Num	Percent
No shift in balance	9	18	50%
The Parent views the Captive as decreasing overall company risk	5	18	28%
The Parent views the Captive as increasing overall company risk somewhat	4	18	22%
The Parent views the Captive as increasing overall company risk significantly	0	18	0%

While responses vary to the question of the top actions both Captive and Parent are managing the shift. Nearly half have refocused their efforts around the credit decision process. The following is a few actions Captives are taking to lower the delinquency rates and improve the credit approval process:

- Refining credit scoring model: In FY 2008, 68% of Captives used credit scoring for transaction decisions (of those involved in small-ticket equipment leasing and finance). Of those who use credit scoring for

transaction decisions, those who made automated decisions based reached 84%.[32] This represents a significant jump from 71% in 2007.

- Enhancing underwriting standards: A prime example is Dell's approach to credit. Dell has "tightened credit requirements over the past 18 months".[33] However, Captives need to be wary of the costs associated with applying more stringent underwriting practices not only from the cost of doing business but also from the loss of customers to competitors.
- Realigning processes: By working closely with the sales team in the prequalification process Captives seek to enhance their underwriting processes through an extra layer of due diligence.

Overall, this suggests that Captives are placing more emphasis on credit approval activities than in the past and moving toward a stronger approach to portfolio management. With this directive on credit and portfolio management and a fresh look at measurements for success, as outlined in the next section, Captive's will be ready to face the next wave head on.

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[32] Equipment Leasing & Finance Association (2009). *2009 Survey of Equipment Finance Activity*. Equipment Leasing and Finance Association.

[33] Dow Jones Newswire (2009, 04-13). H*P Looking For New Lease On Life*. Dow Jones Newswire.

Measurement of Captive Success

The past twelve months have provided a deluge of negative news for the financial services industry and equipment finance providers have borne their fair share of it. CIT may be an obvious example, but more than that, there has been a steady drone of poor results and challenged portfolios displayed in the industry newsletters.

Captive Finance Companies seem to be in the news more than either banks or independent finance organizations—and the news has been dramatically negative.

> ***"Association of Equipment Manufacturers (AEM) reports 80% of member customers are having difficulty obtaining credit to buy equipment"***[34]
>
> ***"Cat Financial Reports Lower Revenue, Profits in Q1/09"***[35]
>
> ***"Will the Obama administration's reforms of the financial system hurt retailers and manufacturers with lending arms?"***[36]

Beyond the news, industry experts—Fitch Ratings for instance—are calling on Parent organizations to reduce the scope of the Captives, de-lever their balance sheets and reduce the volatility associated with combining a Parent company with a financial services organization. Most dramatically they are recommending staying away from financing non-Parent product.

Is this analysis correct? Should Parents be reducing the size and scope of their Captives? Would downsizing help during major downturns such as the one that is occurring now? Should Parents with on balance sheet Captives be looking at establishing Vendor Finance Programs instead? A cursory, traditional financial analysis leads the reader to believe that the answer is yes and the cure, as Boeing Capital had executed a number of years back, was to move to a role more akin to a broker, a conduit for passing "private label" transactions through to a funding source. Minimize exposure, limit risk.

One of the more interesting news items coming during this recent downturn was that Boeing Capital is doing an about face—and moving back into the role of primary funding source.

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[34] Association of Equipment Manufacturers (2009, 08-25). *2009 State of Credit*. Association of Equipment Manufacturers.

[35] Reuters. (2009, 04-21). *Cat Financial Announces First Quarter 2009 Results*. Reuters.

[36] The Economist (2009, 06-26). *GE, GE Capital: Parting Company*. The Economist.

"Boeing has said it expects to provide about $1 billion in financing to buyers of its passenger and cargo jets this year and perhaps more in early 2010"[37]

Having deliberately moved away from a primary funding role a few years back, this move was both surprising and interesting—Boeing can't live with Boeing Capital and it can't live without them!

Is a true Captive right for the parent? In the responses to the survey, as well as discussions with Captive and Vendor Finance Program providers, a number of themes were touched on consistently in response to that question. Exhibit 14 serves to highlight the strengths and weaknesses of the two approaches. While most of the comments to the below listed key considerations (see Exhibit 14) ring true at any point in time, often times the question itself is only raised during significant down or up cycles in the market.

Exhibit 14

Key Consideration	True Captive	Vendor Finance Program
Balance sheet management	Difficult to manage, increasingly so given the current state of the debt and securitization markets.	No or limited impact on Parent.
P&L impact	Portfolio revenue has potential to drive consistent earnings, although often below Parent target returns.	Fee based revenue. Typically limited overall benefit for Parent.
Financial product flexibility	Operating leases (15% of transactions) and higher residuals characterize pricing flexibility.[38]	Greater than 90% loan type products with residuals more than one-third lower than Captives.[39]
New business approval rates	Consistently the highest approval rates in the industry – averaging in the 90% range for the last five years.[40]	Approval rates 25% lower than true Captives. This is often mitigated by incorporating Parent recourse.

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[37] Associated Press. (2009, 05-21). *Boeing Says Funding Available for Plane Buyers.* Associated Press

[38] Equipment Leasing & Finance Association (2009-2005). *2009, 2008, 2007, 2006, 2005 Survey of Equipment Finance Activity.* Equipment Leasing and Finance Association.

[39] Equipment Leasing & Finance Association (2009-2005). *2009, 2008, 2007, 2006, 2005 Survey of Equipment Finance Activity.* Equipment Leasing and Finance Association.

[40] Equipment Leasing & Finance Association (2009-2005). *2009, 2008, 2007, 2006, 2005 Survey of Equipment Finance Activity.* Equipment Leasing and Finance Association.

Exhibit 14		
Key Consideration	**True Captive**	**Vendor Finance Program**
Portfolio management	Greater than30 day delinquency rates close to two times the industry average, yet net losses are less than 20% higher than the industry average.[41] Asset management and customer relationship management are keys to portfolio performance.	Substantially lower portfolio delinquency, usually associated with tighter underwriting standards.
Customer relationship management	Relationship management is complex, but can be more strategic if business units are well coordinated.	Relationship is transaction oriented.
Operational needs	Expensive investment in resources and infrastructure. The Captive is typically a standalone organization.	Leverage capabilities of existing organization and infrastructure.
Strategic alignment	Usually driven from Parent - top down- to the Captive organization. Strong alignment possible.	Conflicting goals at times, especially during economic downturn when third party if reacting to portfolio related issues.

The analysis concluded in this section of the study attempts to address the deeper layer of complexity surrounding defining success for Captive organizations. This alternative view of success often results in different answers than the traditional math and definitely relies on a different equation—one with more variables. The construct of the equation of success is more strategic in nature.

As previously mentioned, a majority of Captives responding to the Captive Survey view support of the Parent sales strategy as a primary mission, with their own business unit profitability coming as a secondary priority. Should this not be reflected in the key metrics used to manage the business and measure success? Clearly the Captives think it should.

What are the traditional measures of success? What are the different components of the larger equation and what should Captives and Parents be paying attention to? What can Captives do to ensure delivering value to the Parent and in turn, their viability, especially as the economy creates strains that test the mettle of the Parent strategy?

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[41] Equipment Leasing & Finance Association (2009-2005). *2009, 2008, 2007, 2006, 2005 Survey of Equipment Finance Activity.* Equipment Leasing and Finance Association.

A New Approach to Traditional Measures

Some of the traditional views of Captives are highly relevant, however often they are benchmarked against the wrong index. Comparing common leverage or profitability ratios between a Captive and its Parent provides negative results in good economic times as well as bad! For instance, average return on assets for a sample of 10 organizations that own Captives in a down year—2008—was 8.7%. The same measure for finance companies over the past 5 years has been 1.2%.[42]

Surely Parents need to pay attention to some key metrics impacting the overall organization. Parent organizations, and public companies in general, focus on measurements like stockholder's equity, earnings ratios, return on assets and return on equity, Captives differ greatly. These differences can be attributed to the differing goals of each organization. The determination of the Captive's success in achieving their goals should be based upon non-financial measures. Therefore, alternative and supplemental views may be appropriate given the evolution of Captives (see Exhibit 15).

Exhibit 15

Traditional Perspective	Measurement Limitations
Diversification of financing beyond the Parent's equipment creates unnecessary risk and should be avoided. Note: There are two aspects to this view—one speaks to the creation of entire business units that finance only non-Parent assets (usually in adjacent markets) and the second focuses on the mix of Parent and non-Parent equipment at a transaction level. The survey and perspectives here address the latter.	Markets, especially the high tech segment, are evolving toward solution selling. Not financing the entire solution (due to non-Parent equipment being in the mix) often results in the financing going to a third party, or worse yet, lost sales for the Parent.

An Alternative Approach

Create policies that balance Parent vs. Non-Parent financing with risk. Risk in the form of both credit and asset management related risks—e.g. increase credit requirements and decrease residual positions as the balance shifts to non-Parent equipment.

In the Captive Survey 77% of respondents reported financing non-Parent equipment and 70% said the Parent had a favorable view of this go-to-market strategy.

[42] Equipment Leasing & Finance Association (2009). *2009 Survey of Equipment Finance Activity*. Equipment Leasing and Finance Association.

Exhibit 15

Traditional Perspective	Measurement Limitations
Profitability measures such as Return on Assets (ROA) and Return on Equity (ROE) are benchmarked against the Parent's returns.	As was discussed earlier, in a traditional view, Captives usually reduces net earnings.

An Alternative Approach

Utilize Equipment Lease and Finance Association (ELFA) benchmarking data for relevant peer Captive data and internally, create a customer lifecycle profitability measure. Acknowledge the incremental profitability driven by the Captive activity, even though it may not directly accrue to the Captive profit and loss statement.

For instance, what is the profitability of my finance versus purchase customers? A recent survey of high tech buyers demonstrated an increase in spending of greater than30% for financing versus outright purchase.[43]

Traditional Perspective	Measurement Limitations
High penetration rates (percentage of Parent's equipment financed by the Captive) and large portfolios (as a percentage of the Parents assets) increase leverage and as a direct result, in economic times such as these, volatility.	Leverage is an important tool for any finance company and it brings with it, both upside and downside implications. Finance industry leverage ratios are relevant benchmarks for the Captive, more than a comparison to the leverage of the Parent.

An Alternative Approach

In addition to a simple leverage measure, as portfolios grow, successful Captives develop the sophistication of their treasury capabilities to develop characteristics which are more like a bank, while less sophisticated Captives tend to continue to rely on the Parent's capital and bank lines as primary financing alternatives.

How diversified is the Captive funding strategy? Is it a sustainable strategy in good economic times as well as bad? Is there a strong financial management capability in place?

Close to 39% of Captive Study participant's funding comes from the Parent and 75% of Captives expressed a strong need to diversify their approach to funding.

[43] Yankee Group IT Infrastructure spending survey.

Exhibit 15	
Traditional Perspective	**Measurement Limitations**
Underwriting standards at Captives are more lax than at banks and other finance organizations. Overall asset quality is reduced, creating exposure during an economic downturn.	Portfolios at Captives have demonstrated a trend of higher delinquency than the overall industry over the past five years,[44] while at the same time, delivering stronger returns than either bank or independent finance firms. In the 2009 Survey of Equipment Finance Activity, Captive's credit approval ratio based on the number of applications was 92% in 2008 (up from 91% in 2007!), a relatively high percentage compared with 65% for independents or 66% for banks.
An Alternative Approach Given the above average approval ratio that Captives have maintained over many years, the median loss rates (charge-offs) are in line with industry averages. Successful Captives have developed a core competency of strong asset management capabilities, that reduce the exposure typically associated with a weaker credit profile portfolio. Certain Captives have put in place credit re-scoring practices and have strong underwriting capabilities. They are reviewing risk and not taking unnecessary risks or if they are, they are putting a premium return on that risk. What is the ultimate loss rate for the portfolio and how does it stand up to industry measures? *Only 22% of Parent's view the Captive as increasing overall company risk in the current economic environment per survey respondents.*	

New Elements to the Equation

In building out the measures of success for the organization some additional, non-traditional metrics should be considered. These measures point to alignment with the Parent and the delivery of benefits that are considered value added from a customer perspective.

The Parent Integration Perspective

A strong strategy for integrating the Captive into the Parent results in both operating efficiencies and increased penetration rates (see Exhibit 16).

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[44] Equipment Leasing & Finance Association (2009-2005). *2009, 2008, 2007, 2006, 2005 Survey of Equipment Finance Activity*. Equipment Leasing and Finance Association.

Exhibit 16	
New Measures	**Benchmarks from the Survey**
How well is the Captive integrating their strategic and go-to-marketing planning with the Parent?	*According to the Captive Survey, 67% of Parents have an important involvement in the Captive strategic planning process.*
How extensive are the Captives shared services with the Parent? Has the Captive moved beyond basic shared services for HR and legal?	*According to the Captive Survey, 37% of Captive functional departments are shared services groups with the Parent.* *Creation of shared service capabilities drive efficiencies of up to 20% (and beyond when leveraging low cost centers of operation).*[45]
Is the Captive integrated into the overall supply chain of the Parent? For instance, are credit processes established and administered at an enterprise wide level? Does the Captive have highly integrated Asset Management capabilities that leverage and interact with Parent inventory management, product lifecycle and refurbishment activities?	*Only 40% of survey respondents report an active integration of Asset Management and Pricing strategies with the Parent inventory management strategy.* *Asset management capabilities are critical to success. Captive residuals are, on average, 74% higher than the industry as a whole.*[46]
Do the Captive's systems integrate directly with the Parent's platforms, for instance, can they create joint proposals for potential customers? Is important customer data shared (easily) between divisions?	*Sixty-one percent of survey respondents' reports focusing on improving technology links with the Parent, yet only 11% report the use of shared, enterprise wide platforms—this is an opportunity for improvement.*

The Customer Perspective

If Captives are truly focused on a sales-enablement strategy, then the customer should be a key input into the success metrics for the Captive (see Exhibit 17).

Exhibit 17	
New Measures	**Benchmarks from the Survey**
Does the finance customer view the Parent and Captive as one organization?	*No Captive responded in the survey that customers always think of them and the Parent as one seamless organization.*
Does providing financing improve customer retention rates for the Parent? Does the Captive have a positive or negative impact on customer satisfaction rates?	*While customer retention benefits as a result of financing are an assumption, there is limited data available to support that contention. Surprisingly, many Parents do not track key metrics related to finance versus non-finance customers. This is an opportunity area for Captives.*

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[45] Data based on Capgemini client experiences.

[46] Equipment Leasing & Finance Association (2009-2006). *2009, 2008, 2007, 2006 Survey of Equipment Finance Activity*. Equipment Leasing and Finance Association.

Exhibit 17	
New Measures	**Benchmarks from the Survey**
Will the Captive promote favorable end of term and mid-term trade up programs that may not be profitable, but promote new equipment opportunities for the customer and the Parent?	*Historically this has been a cornerstone of Captives and a key differentiator from third party financing programs. Over 80% of Captives report providing favorable end of term programs and 70% report offering mid-term programs per survey responses.*

Captive Success in Challenging Times

Leverage, profitability and risk have been traditional measures of financing organizations. However, in the case of Captives, a more in depth view is necessary to understand success and failure in the current environment. A cursory look at Captive metrics in the current climate points to volatile earnings swings, challenges in accessing capital and the potential to subject the Parent to increasing regulatory scrutiny.

Given this economy and those outcomes, why are more Parents not liquidating their Captive financing organizations? The answer lies in a strategic value that links both intercompany alignment and the customer perspective with a larger value equation.

Captives provide an opportunity to build customer loyalty, intimacy, and increase on-going customer communication. They allow for greater or better knowledge of the market. They can also ensure a Parent's product sale by structuring a deal which may not have otherwise been done.

If the Captive can understand the market in which they work, balance customer risk with the premium being offered, maintain core competencies while finding customer diversity, both from a industry concentration and credit perspective, and provide a mechanism to assist not just the horizontal channel, but also the vertical channel, there is a definite value in having a Captive and more importantly in having a successful Captive.

Based on this study of Captives in challenging times, it is imperative for organizations to work with their Parents to develop a common understanding and measurement of the broader strategic value of the Captive and to promote that understanding to the larger community of stakeholders. This enhanced system of measures, aligned with the Captive's true objectives, is less about performance during any given economic cycle and more about strategic value.

Projections on the Future

At a time when Fitch Ratings and other financial writers and analysts predict doom and gloom for Captives, the survey respondents are much more upbeat and widely expect that, as one respondent commented, ***"Captives will evolve stronger"*** from the current economic climate.

If "stronger" is accurate, as Capgemini's analysis believes it to be, then what are some of the lessons to be derived and how will Captives evolve over time? The following is a prediction of the continued evolution of Captives over the next five years:

- Captives will grow in size and complexity, both from a managed portfolio and an organization impact perspective.
- Captives will eliminate 100% third party product financing, however, the bundling of Parent with non-Parent equipment and service financing will increase – dramatically – from the current 20% to over 40%. Solution selling and stronger orientation to "per unit" selling across a broad range of industries will drive this trend.
- Financing penetration rates will increase significantly from the current 33%. The future emphasis on bundled selling will drive Parent's to create offerings that place them in a primary role in the customer relationship.
- The Captive capital structure will undergo a significant upgrade in terms of diversification and sophistication. Balance sheet management capabilities will be upgraded as a result of increasing compliance and the risks associated with a managing a growing segment of the Parent business.
- More companies will pursue a "one organization" model. From a customer perspective, companies will move toward delivering a unified and simplified relationship by including;
  - A single self service website for all relationship information – Parent and Captive
  - One invoice for all products, services and finance amounts due
  - A simplified approach to customer service
- Captive Asset Management capabilities will integrate further with Parent product and inventory planning groups, enabling enhanced residual risk taking.
- Shared services will evolve from the current, limited structure (focus on HR, Accounting and IT) to include additional originations and customer facing groups, such as credit and customer service.

The continued evolution of the Captive will be a stronger, more strategic connection with the Parent and a movement away from the concept of the Captive operating as a segregated, specialized stand-alone business.

Research Methodology

Approach and Strategy for Data Collection

Capgemini has leveraged its finance industry contact repository and research capabilities to reach out to business leaders and gather data and commentary from a variety of Captives. Information has been gathered using the combination of a survey, industry research and personal interviews.

- **Captive Finance Survey**
  An important input into this study was the findings of a Captive Finance Survey. The survey focused on key topics such as key financial data, the operating model, strategic and tactical methods, and Captive independence. Survey responses were submitted confidentially via e-mail or over the phone.
- **Recent Literature / Documents**
  Research led to the inclusion of data from secondary sources. Those sources include: industry analysis performed by the ELFA, academia, Capgemini and other sources, and articles written about Captives.
- **Public Financial Statement Filings**
  As a majority of survey respondents are publically traded companies on US stock exchanges, public statement filings such as 10-K reports were used as supplemental material in this study.
- **Personal Interviews**
  A number of industry leaders were interviewed to gather industry perspective and their point of view.
- **Capgemini Resources**
  Also leveraged was the project work Capgemini has performed with over 35 Captives (with the permission of the company where required) and information gathered through the Capgemini team members involvement in the ELFA.

To protect the privacy and competitive concerns of survey respondents, only aggregate data has been shown in the study.

Analysis of Information

In the preparation of the creation of this report, Capgemini data analysts have employed proven tools and techniques to interpret the information presented in this study. The final communication is offered in a manner conducive for non-experts to quickly understand complex concepts, observations and conclusions. The compilation of data in the form of charts and graphs is

attached in the appendix of the research study. In most cases, the survey data was analyzed holistically given the number of responses. Breakouts into market segment or products were deemed to be too granular to be statistically significant. As a result, all survey tabulations show aggregate information. When necessary, respondents were contacted to clarify responses and populate any null values.

Our industry thought leaders provided interpretation, analysis and insight into the core information gathered. Those findings were transformed into our perspectives about what the future holds for Captives by relying on our "front seat" understanding of the traumatic current events and trends affecting this volatile industry.

Survey Response Statistics

The following section provides a summary of the responses to this study's survey. As respondents did not answer every question, the total respondents to each question may vary. To protect the anonymity of respondents, not all questions are represented in this summary.

1. Profile of respondents by market segment:	
Micro-ticket	1
Small-ticket	8
Middle-ticket	9
Large-ticket	0
Total Respondents	18

2. Average year-end delinquency (> 30 days) stated in % of total portfolio:			
	2009	2008	2007
Year-end delinquency	3.3%	2.7%	2.4%
Total Respondents	14	15	14

3. Profile of respondents' captive lease customers:	
Commercial	83%
Government	5%
Consumer	5%
Other	7%

4. Captive's strategic business planning horizon:	
More than two years	61%
One to two years	31%
Less than one year	6%

5. Priority of the Captive go-to-market strategy within the organization (#1 is highest priority):					
	1	2	3	4	Average Ranking
Aid Parent in growing market share	10	7	0	0	1
Increasing revenue / sales	7	7	4	0	2
Competitive pricing to ensure successful closure of deal	0	3	15	0	3
Investment of surplus capital	0	0	0	17	4

6. Is your expectation that your go-to-market strategy will change in the near future?	
Yes	35%
No	65%

7. Captive finance operational capabilities…	
are superior to industry standards	39%
meet industry standards	50%
are inferior to industry standard	0%
are unsure how we compare to industry standards	11%

8. Regarding Parent strategy, how involved is the Captive in establishing policy and direction?	
Does not participate	33%
Minimal participation	28%
Some participation	33%
Heavy participation	6%

9. Strategic plans in the Parent, for the next one - two years, are expected to:	
Have significant effect on the Captive	50%
Have some effect on the Captive	44%
Have little effect on the Captive	6%

10. Regarding Captive strategy, how involved is the Parent in establishing policy and direction?	
Does not participate	6%
Minimal participation	28%
Some participation	56%
Heavy participation	11%

11. The role of the Captive organization, as it experiences changes due to the current economic environment, is expected to:	
Increase in importance within the organization as a whole	67%
Remain about the same within the organization as a whole	33%
Decrease in importance within the organization as a whole	0%

12. What services are shared across the Captive / Parent organization? (note: respondents have selected all that apply)		
Administration (HR / Legal)	16	89%
IT Support	15	83%
Finance and Accounting	13	72%
Sales	5	28%
Product Support / Maintenance	5	28%
Customer Service Call Centers	4	22%
Asset management	3	17%
Operations	3	17%
Credit	2	11%
Documentation	0	0%

13. What is your current technology structure?	
Best of breed solutions with limited integration with the Parent	71%
Best of breed solutions with automated integration between the Captive and Parent	17%
One enterprise solution used by both the Captive and Parent	12%

14. What is the future technology strategy?	
Increased integration between the Captive and Parent systems	61%
Change to autonomous best of breed solutions	22%
No change	17%
One enterprise solution	0%

15. What is guiding your technology strategy for the future? (note: respondents have selected all that apply)		
Modern technology improvements	11	61%
Legacy system redundancy / support improvements	10	56%
Corporate policy changes	5	28%
Other	5	28%
Corporate technology funding changes	4	22%

16. Is the Captive % of parent sales increasing, decreasing, or remaining the same?	
Increasing	67%
Remaining the same	17%
Decreasing	17%

17. In the future, the percent of the Captive's financed equipment / assets from the parent is:	
Expected to remain the same	56%
Expected to increase	31%
Expected to decrease	13%

18. Does the Captive have the capability to go to market with equipment / assets which are not parent branded?	
Yes	76%
No	24%

19. Are there incentives for financing Captive brands over non-Captive? (note: respondents have selected all that apply)		
Blind discounts / subsidies	5	50%
Lease rate factor adjustments	5	50%
Other: Rarely / do not finance non-Captive brands	4	40%
Sales commission	3	30%

20. Is it the perception of the Captive that financing equipment / assets, not branded by the Parent, is beneficial?	
Yes	71%
No	29%

21. Reasons for financing equipment / assets, not branded by the Parent: (note: respondents have selected all that apply)		
A more robust offering	11	61%
Financial gain	10	56%
Maintaining market share	3	17%
Other	10	56%

22. How does the Customer perceive the Captive and the Parent?	
The customer always sees one seamless organization	0%
The customer usually sees one seamless organization	50%
The customer sees two separate organizations	50%

23. Is there a Customer Relationship Management (CRM) system in place to maintain one view of the customer for both the Parent and Captive?	
Yes	44%
No	56%

24. For Captive deals, does the customer deal mainly with the Parent or Captive?	
Captive	83%
Parent	17%

25. Average percentages for source of financing funds:	
Parent Company Capital	39%
Bank / Institutional Financing (e.g. lines of credit)	26%
Access to financial markets (e.g. securitization, commercial paper, etc)	22%
Standalone capital structure (separate from Parent)	13%

26. Regarding the Sales Model, average percentage of sales fall into the following categories: (note: respondents have selected all that apply)	
Parent Sales and Captive Sales which work together	45%
Sales which are generated through third party dealers / vendors	36%
Parent Sales and Captive Sales which close their transactions independently	11%
Captive Sales which is usually not directly involved in the Sale and Financing (Sales are handled completely by the parent)	8%

27. Regarding Parent strategy, how involved is the Captive in establishing policy and direction? (note: respondents have selected all that apply)		
Creating new financial product offerings	12	71%
Creating pricing packages (bundled packages or special configurations)	11	65%
Developing marketing materials	10	59%
Generating new customers	9	53%
Sales calls	8	47%
Establishing sales goals	3	18%
Other: Sustained Dealers	1	6%

28. Regarding Captive strategy, how involved is the Parent in establishing policy and direction? (note: respondents have selected all that apply)		
Creating pricing packages (bundled packages or special configurations)	11	65%
Generating new customers	11	65%
Sales calls	11	65%
Developing marketing materials	10	59%
Creating new financial product offerings	9	53%
Establishing sales goals	8	47%
Other: set goals for fee revenue	1	6%

29. How does the Captive end of term (EOT) strategy line up with the Parent's customer retention strategy? (note: respondents have selected all that apply)		
Proactive Captive sales and remarketing of financing equipment	15	88%
Provide favorable EOT options	14	82%
Promotes mid-term upgrades	12	71%
Offers trade-in credits for returned equipment when financing new equipment	10	59%
Provides payout quote excluding remaining unearned income	9	53%
Other	1	6%

30. How does the Captive end of term (EOT) strategy line up with the Parent's equipment inventory strategy? (note: respondents have selected all that apply)		
Market demand (hot, warm, cold) influence FMV price on purchases	11	61%
Parents inventory level controls Captive's direct and remarketing strategy	6	33%
Evaluates inventory levels when determining EOT pricing	6	3%
Returned equipment goes directly to the Parent to have greater control of the resell market	5	28%
Other	1	17%

31. Priority of the Captive strategy within the organization:						
	Strongly Disagree	Disagree	Some-what Disagree	Some-what Agree	Agree	Strongly Agree
Increase credit analysis / awareness	0	0	0	2	5	11
Increase funding diversification	0	2	0	2	4	8
Increase realignment of Parent and Captive funding	0	2	0	2	4	8
Increase mergers and acquisitions	0	2	0	2	4	8

About the Authors

Capgemini is a world leader in consulting, technology, and outsourcing. The firm, headquartered in France, was founded over 40 years ago and has grown to over 90,000 employees operating in more than 30 countries with 2008 revenues of €8.7B. Capgemini's mission is to empower their clients to respond faster and more intuitively to changing market dynamics.

Capgemini currently serves more than 900 clients with a network of 12,000 professionals in the financial services industry. Capgemini Global Financial Services provides transformational solutions in Banking, Insurance and Capital Markets, and provides industry recognized thought leadership.

The authors of the ***Captive Finance Firms in a Challenging Economy: Facing the Wave*** study are members of Capgemini's Asset Finance practice, a specialty group in the Financial Services sector. This group focuses on the Equipment Finance and Leasing market and works daily with companies in the industry to help them develop more efficient and profitable operations. They have proven expertise in all areas of asset finance from originations to lease / loan management, and ultimately asset disposition and work with large, globally diversified financial firms and small independent equipment finance firms, providing expertise in every asset ticket size—from micro to large ticket.

The authors and contributors to this study include Caesar Bernardo, Josh Bridge, Steve Byrnes, Mark Jones, Ken Kelliher, Cameron Krueger, Amish Patel and Christine Williams.

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[47] The names of the participating companies have not been included in this report in order to maintain the confidentiality of their respective data.

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