EQUIPMENT LEASING & FINANCE
FOUNDATION
*Your Eye On The Future*

# The Place of the Independent Equipment Leasing and Finance Company

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

The Equipment Leasing and Finance Foundation commissioned The Alta Group to study Independent lessors within the context of the US equipment leasing and finance business. For purposes of this study, we have defined Independent lessors as equipment financiers that:

• Maintain their own treasury function to raise capital
• Hold more than 50% of their originations on their books
• Are not owned or controlled by a bank, equipment manufacturer, or industrial company (although they can be partially owned by an outside entity)
• Are not in the position of having a safety net for the enterprise, e.g., a parent or government guarantee
• Are not regulated by banking authorities.

Whereas, the **role** of Independents is the same as that of other equipment financing companies, the **place** of Independents in providing equipment financing differentiates them from captives, bank leasing companies, and subsidiaries of industrial companies. In this respect, most successful Independents consider themselves to be more than simply a source of financing, with the financing component simply one aspect among the palette of client solutions offered. The overarching purpose of this research is to determine how Independents, as a group, build and sustain their place within the overall industry.

The Alta Group carried out this project with several key Independent stakeholders in mind, including lenders and other capital providers, vendor channel partners, customers, competitors, and most importantly, their own leadership. We regard one of the greatest values from this study to be the prospective application by each stakeholder of its lessons and ideas.

John Deane
CEO

The Alta Group℠

## Executive Summary

Independents have demonstrated successful characteristics, strategies and practices as their place in the industry has changed over 40 years. During the interviews with industry executives, terms like innovative, entrepreneurial, flexible, nimble and creative were used to describe Independents. All of these characteristics exist in successful Independents, but how each plays out differs in execution. There is not a generic Independent. Successful Independents share many of the characteristics, strategies and practices described in this study, but the applications in actual *Value Propositions* vary.

> Independents started the equipment leasing and finance industry and their *Place* continues to be on the cutting edge of the industry. The Place for Independent Companies has been differentiated and continues to be set by five factors:
> • What competing companies will not or cannot do.
> • The continuing maturation of equipment leasing and finance as a product set from new to commoditized.
> • Innovation and entrepreneurship.
> • The changing customer / end user and their needs.
> • Adaptation to changing environmental factors such as technology, law, capital markets and regulations.

***The universal concept that defines Independents is … independence!***

The universal concept that defines Independents is . . . independence. Independents are independent, the concept seems so obvious. But above all else, the many decisions that executives make are colored by independence – freedom to follow your own compass in your own way.

There are limits and external factors that Independents must navigate. The ability to: attract competitive funding, weather economic ups and downs, monitor and react to changes in asset values, recognize changes in customers' needs, understand changes in channel markets, implement needed changes in operational requirements and recognize changes in competitors are just a few of the realities Independents, and all companies, face. Independent companies that have sustained success and grown have made that navigation successfully. Successful future navigation will require the same vision and execution.

Independents offer a *Value Proposition* to their customer based on customer focus, specialization in a "niche", industry knowledge, flexibility / adaptability to what it takes to deliver a solution to the customer and relationship management. To make this work and sustain the Independent, there must be a demand for this general *Value Proposition*. This *Value Proposition* of Independents in turn thrives on change and uncertainty that creates inefficiencies to solve. Inefficiencies include market disruption, fear, uncertainty, a clouded business environment and instability. By comparison, Banks need stability and higher certainty to make their *Value Proposition* — characterized by inexpensive and plentiful capital availability — work for them.

***The primary determinant of an Independent's success is the quality of entrepreneurial leadership and management!***

Entrepreneurial leadership and management are constants in successful Independents. The equipment leasing/finance industry entrepreneur leader-manager can adeptly materialize their vision for the company. The leadership and management are professional in the sustained company. They have knowledge and experience in equipment finance. They know whether they have the means and abilities to execute on their vision. They know how to mitigate identified business development and operational deficiencies. They have the desire…some call this "drive." What the Independent entrepreneur apparently needs is the opportunity. Opportunity is created most frequently in times of market change and uncertainty.

Opportunities to grow do exist for Independents, but these opportunities need to be recognized and evaluated in a timely fashion and with rigor and vigor. Solutions to potential customer needs are inherent for new product and market opportunities. They must be devised quickly before competitors embark upon the same solution. With the right leadership, Independents can and do react well to opportunities that present themselves. Opportunities exist, but solutions / value must be created. The solution / value-add must be fundable. The primary factor for a company to do the above is having the right leadership.

**The primary external determinant of success is access to consistent funding!**

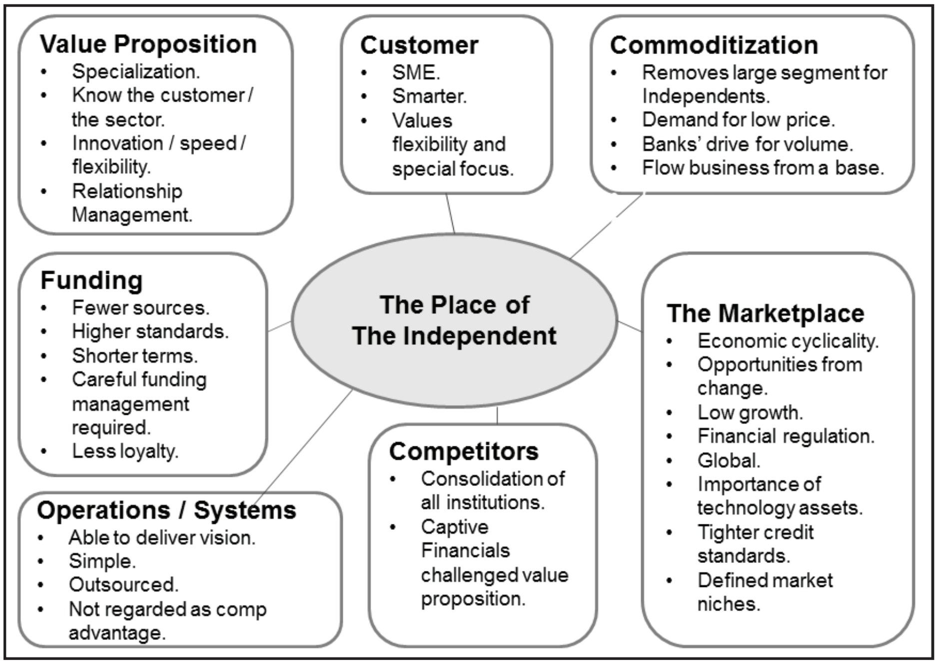
Access to funding under favorable terms and at a reasonable cost is essential for an Independent's immediate and sustainable success. The funding strategy and process must ensure a constant and reliable source of funding from a variety of sources and utilize a variety of forms if possible. The Independent's business depends on presence - being there - for its channel partners and customers, and without funding that consistent dependability does not exist. A good funding strategy obviously includes profitability and the creation of equity. Successful Independents are also sophisticated in pricing off their funding costs by seeking different levels of returns for equity and debt. Equity deserves a larger return and the creation of additional equity requires pricing discipline.

The following illustration shows the many factors and considerations that determine *The Place of Independents* individually and collectively. Leadership and management pull it all together into a sustainable business, starting with a clear *Value Proposition* as described below.

*The Place of Independents* is different from The Place of Brokers. However, because so many brokers consider themselves as Independents, a few observations are in order. Brokers generally are not in business to fund and retain an on-book portfolio of equipment leases and loans, at least not for any period of time. Brokers may also be specialists however, and respected Brokers are known for carefully and professionally managing customer relationships (lessees) and funding relationships (transaction buyers) simultaneously. While many are good originators, most do not actively engage in administrative and portfolio operational duties. Some observers would characterize Brokers as true Independent "wanna-bes." Indeed, some Brokers – with the demonstrated successful operation stemming from proven leadership may gain access to ongoing capital to evolve into Independent companies over time.

Independents once held the dominant market share in equipment leasing and finance. However, consolidation and the aggressive growth of Captives and Banks relegated Independents to third place. But even with a relatively small market share today, the market size of $200 - $250 billion in new business volume annually presents a large and diverse playing field in which medium and large Independent companies can find good niche markets and develop valuable specialties.

This study demonstrates that not only is there a place for Independents, but that a market need exists and the place can be sustainable and successful with the right executive leadership and with the right value proposition.



# Independents' Role in the Equipment Finance Marketplace

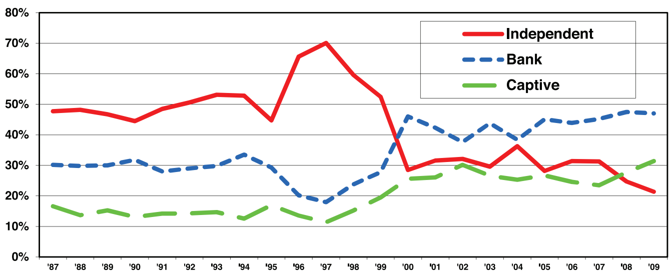
Independent companies were in on the ground floor of the equipment leasing and finance business and were dominant for several decades, although this position has shifted for reasons that should be understood by all industry stakeholders. This section of the study identifies how Independents fit in the current equipment leasing and finance environment.

## Volume and Net Asset Trends

Since the early 1980s, the Equipment Leasing and Finance Association (ELFA) has surveyed its members annually and reported this demographic data in what is now called the Annual Survey of Equipment Finance Activity. The ELFA began capturing the lessor type in 1987 which enabled segmentation of many data elements by Bank, Captive, and Independent lessors.

In 1987, 308 lessors, representing $33 billion in new volume, participated in this annual survey, including 172 Independent companies that generated $17.5 billion of volume. Independents were the dominant force in equipment leasing that year, representing close to 50% of total association member participation and volume. This dominance peaked in 1997, as can be seen in **Figure 1**.

**Figure 1**
**Percentage (%) of Annual New Business Volume by Company Type**




<u>Sources</u>: AAEL Survey of Industry Activity (1988-1990); ELA Survey of Industry Activity (1991-2006) ; ELFA Survey of Industry Activity (2007) / ELFA Survey of Equipment Finance Activity (2008-2010)

It appears that 1997 was a pivotal year for the Independent sector of the leasing industry as Independent volume peaked at $84.5 billion, representing a 71% share of the lessor market. The Independents' market share then began a period of decline and subsequent flattening through 2009. Over this span, while Bank and Captive volume collectively grew by over $48 billion, the Independents' annual volume remained virtually unchanged. As a result, the Bank and Captive share of new volume increased by 6.3% and 7.2%, respectively, while the Independents' share of new business volume declined by 0.03%.

> *.....industry consolidation has taken a toll on Independents.*

The Monitor 100 net asset data also reflects this decline in the Independents' market position, as Independents' net assets declined from 11% of the total in 1991 to only 4% in 2009. Much of this decline is attributable to acquisitions of some Independents by non-Independents. Although the number of Independent companies remained relatively constant, as illustrated in **Table One**, several prominent, high-volume companies previously counted as Independents either have exited the business or no longer exist as separate companies. A representative list of these companies is shown in **Table Two**.

**Table One**
**Number of Companies by Company Type**

| Number of companies in Monitor 100™ | 1991 | 2009 | '91-'09 change | 1991 % | 2009 % |
|---|---|---|---|---|---|
| **Company type** | | | | | |
| **Independents** | **25** | **26** | **+ 1** | **25%** | **26%** |
| Banks - International | 14 | 8 | - 6 | 14% | 8% |
| Banks - US | 35 | 43 | + 8 | 35% | 43% |
| Captives | 9 | 17 | + 8 | 9% | 17% |
| Not elsewhere classified | 0 | 5 | + 5 | 0% | 5% |
| US industrial subsidiaries | 17 | 1 | - 16 | 17% | 1% |
| **Total** | **100** | **100** | **0** | **100%** | **100%** |

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An analysis of **Table Three** validates the premise that, while the number of Independents in the industry remained steady, the volumes being generated by Independents did not. As seen in Table Three, almost two and one-half times as much volume exited the Monitor 100 as entered it over the period from 1992 to 2009.

**Figure 2** provides an additional view of trends in new business volume by type of company that affirms the conclusions drawn from the ELFA data. Figure 2 represents companies in the Monitor 100™ and, in some cases, may include other lines of business and international equipment finance operations.

**Table Two**
**Lessors no Longer Grouped as Independents**

| Company | Estim Exit Year | Disposition |
|---|---|---|
| ICX Corporation | 1994 | Purchased by National City Bank and now part of PNC |
| Oliver-Allen Corporation | 1994 | Purchased by US Bank Corp Leasing |
| US Leasing | 1994 | Purchased by Ford Credit and then by Mellon Bank |
| Capital Associates | 1999 | Dissolved |
| LeaseTec | 1999 | Purchased by Key Equipment Finance |
| NewCourt Credit | 1999 | Purchased by CIT |
| Senstar Capital | 1999 | Purchased by John Deere Credit |
| Winthrop Resources | 1999 | Merged into TCF |
| Heller | 2000 | Purchased by GE Capital |
| Associates Commercial | 2004 | Purchased by CitiCapital |
| Charter Financial | 2004 | Purchased by Wells Fargo |
| Comdisco | 2004 | Liquidated |
| DVI | 2004 | Liquidated |
| Finova Group | 2004 | Liquidated |
| UniCapital | 2004 | Liquidated |
| Relational LLC | 2009 | Portfolio being liquidated via remarketing agreement with Macquarie |

**Table Three**
**Independent Movement in the Monitor 100™ ($ Billion)**

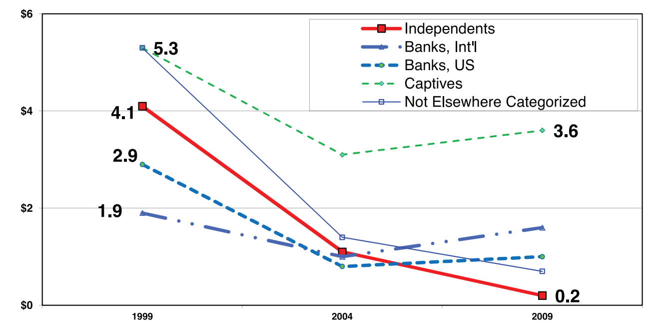
| Time period | '92-'95 (3 yrs) | '96-'00 (5 yrs) | '01-'05 (5 yrs) | '06-'09 (5 yrs) | '92-'09 (18 yrs) |
|---|---|---|---|---|---|
| Monitor 100™ entrants | $4.78 | $10.32 | $3.27 | $5.73 | $24.10 |
| Monitor 100™ exits | (5.72) | (8.45) | (41.92) | (1.46) | (57.55) |
| **Net change** | **($0.94)** | **$1.87** | **($38.65)** | **$4.27** | **($33.45)** |

Much about the Place of Independents can be understood better by examining the arrival and departures of companies to/from the Monitor 100. Asset changes and numbers of companies in each category need to be viewed together to understand what has happened in the equipment leasing and finance marketplace. Such an analysis clearly points out that industry consolidation has taken a toll on Independents.

## Other Factors

There are many factors that may cause a company to lose market share, one of which, in the case of Independents, was industry consolidation. Others might include an inability to react to the market, or lack of profitability due to inadequate pricing policies or cost structures. When examining the decline in Independents' market share, one must question if factors such as these played a role.

**Figure 2**
**Average Annual New Business by Company Type ($ Billion)**




Sources: Monitor 100™ May/June, 1992; Monitor 100™ May/June, 1995; Monitor 100 ™ June, 2000; Monitor 100™ June 2005, 2010 Monitor 100™ Issue 2010. © 2010 Xander Media Group. *Monitor™* is a Xander Media Group (XMG) publication. Used with permission.

The ELFA survey began measuring lessor volume by origination channel in 2001, thereby adding additional value to the data. These channels include direct sales, vendor programs, and third-party purchased. As expected, Captive lessor volume was almost exclusively generated through their own vendor programs. Some interesting trends emerged around Independent and Bank origination activities, however.

Ten years ago, Independent and Bank lessors each originated over 60% of their new finance volume through direct sales efforts. While Bank direct volume dropped to 45% in 2009, Independent direct volume fell to 31%, as significant vendor channel migration occurred. In fact, Independents' vendor origination percentages almost doubled from 2001 to 2009, as Independents sought new and less costly origination options.

Third-party purchased business essentially remained flat over this period for Bank lessors. Independents, on the other hand, saw the third-party origination channel grow from 14% to 21%, again, as Independents identified alternative channels to increase their asset base. These business changes reflect the opportunistic and entrepreneurial nature of Independents.

All lessor segments experienced a marked drop in both cost of funds and transaction/portfolio yields in the eight-year period from 2001 to 2009, as illustrated in **Table Four**. Yields narrowed and annual charge-offs increased, resulting in a notable reduction in net spread. As can be seen from this data, however, it is clear that Independents were not underperforming the market as a whole, further suggesting that the decline in market share is not performance-related.

**Table Four**
**Pretax Performance Metrics**

| | 2001 | | | 2009 | | | Change: 2001 to 2009 | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Indep** | Bank | Captive | **Indep** | Bank | Captive | Indep | Bank | Captive |
| Yield | **10.4%** | 10.3% | 9.7% | **8.7%** | 6.6% | 7.8% | **1.8%** | -3.7% | -1.9% |
| Cost of funds | **5.3%** | 5.1% | 5.8% | **4.0%** | 2.9% | 4.2% | **-1.3%** | -2.2% | -1.6% |
| Gross spread | **5.1%** | 5.2% | 3.9% | **4.7%** | 3.7% | 3.6% | **-0.5%** | -1.5% | -0.3% |
| Charge-offs | **1.0%** | 0.7% | 0.7% | **1.9%** | 1.3% | 2.1% | **0.9%** | 0.6% | 1.4% |
| Net spread | **4.1%** | 4.5% | 3.2% | **2.8%** | 2.4% | 1.5% | **-1.4%** | -2.1% | -1.7% |

**Sources**: ELA survey of Industry Activity (2002); ELFA Survey of Equipment Finance Activity (2010)

It is apparent that Independents are doing something right, since they continue to be acquired and/or perform in today's equipment finance market. What, then, are the factors that make them successful? The place of the Independent in equipment financing is examined in the next section.

# Building and Sustaining a Successful Place

Each company in the equipment leasing and finance business, regardless of type or size, faces similar questions in conducting its business. Furthermore, each company will answer the questions differently. It is these differences in answers that determine the place of each type of company in the equipment financing industry.

It is the questions that each company must answer that form the structure of this section of the study. These questions are:

- What market niche(s) should our company select and who do we want for customers?
- What value will we deliver to the customer and how will we deliver it?
- How will we make money?
- How will we organize ourselves and operate?
- How large should we be and how can we do both in terms of scale and scope?
- Do we have the leadership and management to sustain growth and success?

## Selecting the Customer and Market Niche

Businesses and business models are distinguished by the markets they select to be in and the customers they choose to target. From an early time, equipment leasing and finance leaders chose markets that provided premium pricing opportunities over those with commodity pricing. Over time, that trend changed as more companies, particularly Banks, matured into commodity businesses, and the risk and reward attributes that accompany commodity markets began to appear.

However, most successful Independent companies did not follow the commoditization trend. Independents recognized that, for the reasons explored later in this study, they must avoid markets defined by low pricing and focus, instead, on those markets where premium knowledge and experience is valued. While there is no generic model of an Independent, these companies share several characteristics that have been key to their success.

Independents select market and customer opportunities based on speed, flexibility, knowledge of the assets, and knowledge of the particular market sector. They do not select markets in which customers only are driven by price unless they have something to add that is valued by a customer or channel partner. With these themes in mind, Independents ask themselves variations of the following crucial questions:

- **Market/asset knowledge:** Is this a market in which the Independent can know more about the customer/channel partner and how the assets work than other competitors?

- **Distinct market complexity:** Is there some complexity in this market niche? Niches that require customization, flexibility, and are solutions-oriented attract Independents. Independents use knowledge and industry expertise to address complexity or solve the minor inefficiencies that larger or more commoditized companies will not address.

- **Company alignment:** Can the Independent align with how business is done in a market niche? Do they have, or can they get, the capabilities needed to compete? Practitioners interviewed for this study stated repeatedly that many Independents fail to explore this adequately. Instead, they let their entrepreneurial confidence take over and delude themselves that they can do it all with what they have. One leasing executive said that too many Independents, particularly smaller ones, are just "deal chasers" and cannot sustain success. They do not actually have a market-focused attitude. Another stressed that you must look ahead and understand the scale of what your commitment ultimately must be.

- **Customer needs and profile:** What is the profile of customers in the market sector and how are their needs currently being met? Many Independents select smaller to medium-sized customers with whom to do business, as large companies too often have multiple financing options and attract larger financing sources. SMEs (small and mid-sized enterprises) usually place more value on the benefits delivered by Independents such as speed, convenience, and flexibility for unique needs. This is not to say that Independents do not do business with large companies. They do, but they will tend to seek out unique pieces or segments of a large company where the scale is modest and the service is valued

***.... most successful Independent lessors did not follow the commoditization trends.***

- **Company market niche relevance:** Is this a market niche in which the Independent can be relevant, one in which the scale that can be achieved justifies the investment of time and money?

- **Reward for early market entry:** Is this a market in which early entry will be rewarded? Banks tend to be slow to enter newly developing market niches and Captives do not generally appear in new markets because market size has not yet created the scale for a captive. However, the Independent must invest the time to learn about the market and identify where and how value can be added

- **Unique value delivery:** What does the Independent believe the market will reward? Can it deliver that value? Is there a particular perceived value that the market does not yet understand that can be sold? Sustained success requires the ability to be unique and premium pricing requires uniqueness.

- **Market specialty:** Can the Independent be a specialist in this market sector? Historically, Independents have not been generalists and the successful ones have had a specialty defined in some way and branded as such.

- **Tax incentives:** Are tax incentives for investment important in this market niche? As tax incentives for leasing have declined over time, so has the importance of tax incentives to selecting a market niche. In addition, a lessor has to have a large tax liability to manage to sustain a tax leasing business. As an alternative, some Independents have developed a funding strategy that allowed funding partners to use tax benefits, but these strategies are less common today.

- **Funding/capital access:** Can the Independent locate competitive funding for the transactions in this market sector?

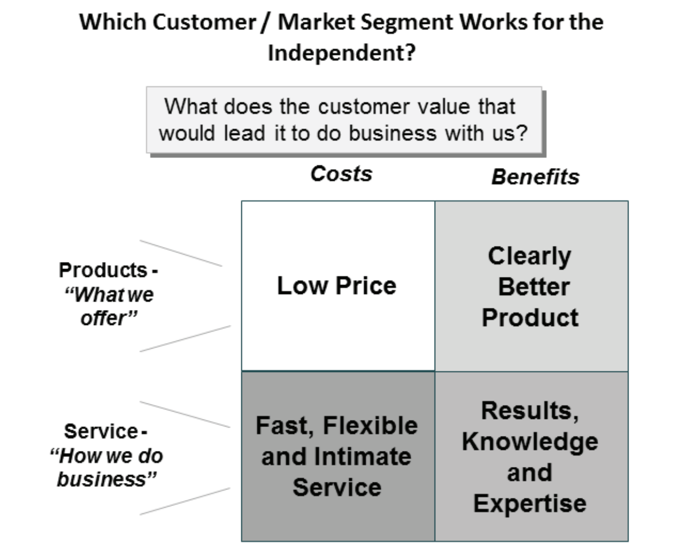
Based on Alta interviews and observations, Independents generally compete by adding value through (1) fast, flexible, and intimate service, (2) results, knowledge, and expertise, and (3) a clearly better financing product or delivery structure. These value added factors drive the decisions to be made by Independents when selecting market niches, customers, and value propositions.

Equipment finance executives interviewed for this study were quite consistent in describing the market types in which Independents can perform best. The market features mentioned most frequently in Alta's interviews were needs and reward, niches, and scale.

***Market needs and rewards***

Independents traditionally have attacked markets and customers in which the rewards are higher due to customer service and close relationships, preferring to stay away from, or leave, commoditized markets. **Figure 3** identifies

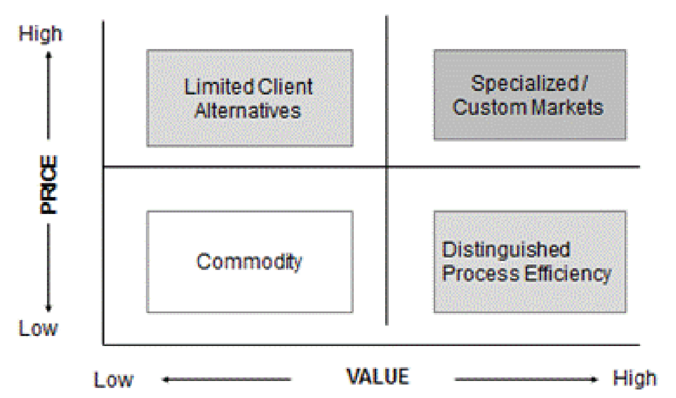
**Figure 3**
**Customer Market Segments**




the costs and benefits of two, typical customer approaches.

In addition, Independents select markets in which customers have limited alternatives and the Independent's specialized market knowledge and its ability to customize gives it an advantage, as illustrated in **Figure 4**. Distinguished process efficiency is a goal but not necessarily a competitive advantage unless a certain level of scale is achieved or the process is related to customer relations.

**Figure 4**
**Price/Value Continuum for Independents**




### *Market niches*

Equipment financing executives interviewed stated overwhelmingly that Independents and Captives tend to be far more specialized than Banks. For Captives, specialization is obvious because of the parents' products, whereas Banks need to support the Bank's franchise and product offerings. Because an Independent is just that – independent - it is in a position to constantly select market sectors in which it can build specialization.

Aircraft leasing is a good example of a niche market and how it changed over time. This niche has gone through cycles in which Independents' share was strong, then declined and subsequently rose again. With the exception of International Lease Finance Corporation (ILFC), GE Commercial Aviation Services, and several smaller Independents, aircraft leasing became more and more of a long-term financing option with heavy participation by banks during the 1980s and well into the 1990s. However, many of these Independent aircraft lessors, with their ability to actively manage the unique risks in this sector, offered more value than the Banks.

With multiple bankruptcies among legacy carriers, deregulation, and lower air fares disrupting the economics of commercial aviation, Banks have pulled back over the past 10 years. Credit risk, collateral risk, and the needs of the scheduled airlines changed the market. The Independents weighed in with shorter terms and the ability to move aircraft around among a variety of customers as required.

At the other extreme from a company like ILFC is Boston Financial & Equity Corporation (BF&E), a small second-generation company in Boston. BF&E has built a niche around providing financing solutions in unusual situations in which the lack of history, cash flow issues, and the need for customized transactions excludes most traditional financing sources. BF&E is an example of a niche player that has developed a reputation around its ability to deliver on a specific value proposition. These value proposition specialties are hard for a competitor to replicate, making entrance into that niche quite difficult, even for companies with access to cheaper capital.

There are many variations in value propositions depending on niche, transaction size, and/or asset type. For example, historically, technology was a major market niche for Independents, as technology aligned many of the right ingredients for Independents, such as new and emerging products, accelerating demand, asset management opportunities, and risks to be managed. The aggressive entry of Captives over the past 15 years, however, plus the recent capital constraints, have made it more difficult for most Independents to create a technology niche unless they have a long history in it or have the right strategic partner.

**Table Five** summarizes the market sectors selected by Monitor 100™ Independents. This data reflects the diversity found among Independents' niches, as most of the companies enumerate three sectors in which they compete. How do successful Independents select the right market niche? Interviewees were asked to respond along a continuum ranging from intuitive to structured approaches and contrast themselves with their Captive and Bank competitors. Not surprisingly, those interviewed consistently concluded that Independents as a group are far more intuitive.

**Table Five**
**Niches Selected by Monitor 100™ Independents**

| Primary sector | Number of companies | Common additional niches |
|---|---|---|
| Agriculture | 1 | Industrial/trucks |
| Marine/rail/air | 5 | Industrial/construction |
| Industrial/energy | 12 | Trucks/telecom/medical |
| Office-related | 4 | IT/medical/telecom |
| Construction | 5 | Trucks/industrial |
| Telecom | 8 | IT/office/ industrial |
| Trucks/trailers | 6 | Construction/industrial |
| Food | 2 | Trucks |
| IT | 8 | Medical/office/telecom |
| Medical | 7 | IT/office/industrial |

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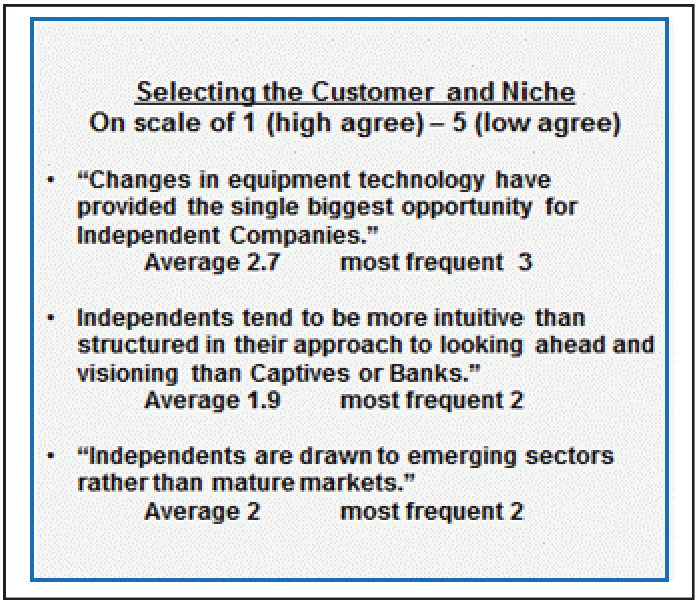



All made it very clear, however, that being intuitive or entrepreneurial does not mean "flying by the seat of your pants."

Nearly all the executives Alta interviewed stressed that professional managers in all companies, including Independents, have a process. Banks and Captives are likely to have highly structured processes that are imposed by the parent organization, as opposed to Independent processes, which tend to be self-imposed and require self-discipline to consistently follow. The Independents' processes often are not a system – it is, instead, a style of leading and managing. The most common words used to describe the Independents' process style were real time, networks, alert, proactive, speedy, flexible, and opportunistic.

One executive with a mid-sized Independent company described the process as ". . . strategy is initially opportunistic – focus on the niche selected and then go where the customer or market takes you." To do this, flexibility and speed are critical to success. Or, as one leader stated, "I just have to outrun you." Many Independent executives stressed that the successful executive and manager remains very alert to all the factors that can impact a marketplace or customer group. In this sense, being intuitive is not in conflict with discipline and adhering to a risk and reward model. To be successful in the long term, however, the intuitive style must be professional

This intuitive and opportunistic style is reflective of the entrepreneurial attitude that Independents must bring to the marketplace. Without the protection of a parent company or other large scale institution, the Independent must rely on its wits and agility to survive. These characteristics are what define an entrepreneur, a term that almost always is used as a positive within the true meaning of a free and creative marketplace.

Another important aspect of entrepreneurship is the notion of the "creative mindset" that helps entrepreneurs create new ideas and bring them to the market. This creativity requires an open mind and the willingness to dig for all the needed facts. Entrepreneurship, however, does not always have to represent an innate quality.

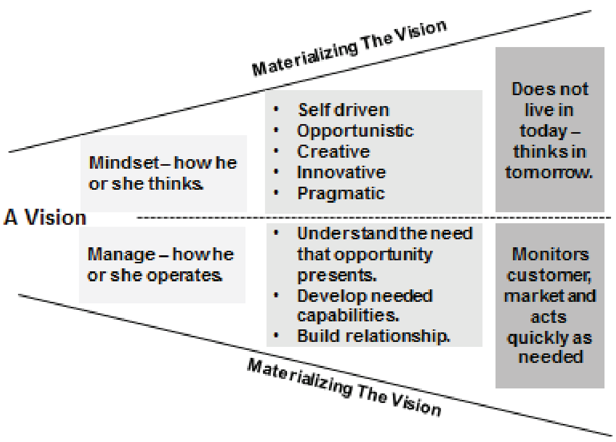
A classic approach, such as one advocated by Peter Drucker, states that practice in business rests on theory, hence, an entrepreneur has to learn how to find and interpret the symptoms of need and opportunity, so the knowledge can be used to implement the business practice to seize an opportunity. This is a very down-to-earth, mechanical approach in which entrepreneurship is understood to be a practice.

With this approach, there are techniques one has to learn. For example, Drucker describes several methods to identify opportunities, one of which is "seeing change and reacting to it." With this method, fields of opportunity such as a growing market, or the consequences of rapidly changing conditions or circumstances, can be identified. Entrepreneurs then can devise businesses and product solutions to address the new needs.

Sometimes entrepreneurialism is associated with innovation, risk taking, being proactive, or having a leader who has a sort of 'aha moment' when she or he encounters an opportunity worth the venture. In this context, entrepreneurialism is seen more as a way of operating than simply thinking. To put this in perspective, being non-entrepreneurial can be described as an approach that is focused on creating order and efficiency through controlling, evaluating, and administrating practices.

It is assumed that, for purposes of this study, being an entrepreneur in the equipment leasing and finance business means that the leadership and management can materialize its vision, and furthermore, have the means, ability, and desire, that is, the "drive," to do so. What the Independent entrepreneur definitely needs, though, is an opportunity. **Figure 5** helps to understand entrepreneurial leaders.

Figure 5
Components of Entrepreneurial Leaders




Executives vary in their level of agreement as to whether Independents are drawn to emerging or mature markets. When asked their level of agreement with the following statement "Independents are drawn to emerging sectors rather than mature markets," on a scale of 1 – 5, with 1 being highly agree, most responded either 2 or 3 with the rest responding 1. Although there appeared to be a slight bias to the emerging market sector preference for reasons already described, some specific observations are worth noting:

- Emerging markets have less competition and more imperfections to address.
- Being in a market early creates an edge.
- Sustained companies stick to what they know and do well. If an emerging market can be found where there is an application, entry can be justified, but caution should be used to balance opportunity with sustainability and growth.

Is it easier to be an entrepreneur in a small market niche rather than a large market niche? There is not a definitive answer to this question and executives vary in their perspectives. Changing conditions, emerging inefficiencies, or scale too small for commoditization, even in a mature market, can provide opportunities. The interview group executives in the study consistently stated that entrepreneurs can exist in either emerging or mature market sectors, depending on the conditions.

If the Independent truly is entrepreneurial (can materialize its vision as illustrated in Figure 5), and most executives believe that true entrepreneurs are not that plentiful, it can succeed in large or small market sectors by identifying the right opportunity and avoiding excessive risk. However, if the Independent is not entrepreneurial, or if it is generic, it should stay only in small markets where the larger and entrepreneurial companies will not tread.

Finally, an Independent does have to be able to fund transactions in its selected market segments. For example, is this a niche or segment in which residual positions can be part of the transactions? If so, a high demand for equity is created to be a player. In addition, trends related to credit quality in the sector as well as susceptibility to cyclicality of all kinds will affect funding.

### *Market scale*

Independents seek out markets with potential scale such as emerging or underserved markets. Scale for Independents should be large enough to make the market efficient. Conversely, if a market's scale becomes too large, it may be time for the Independent to get out because it will attract commoditizing elements and make the market competitively unattractive. At the same time, some growing or large market sectors may spawn new offshoots – little niches. Attentive Independents will be early to recognize their emergence and can shift into those more attractive areas based on their knowledge and experience.

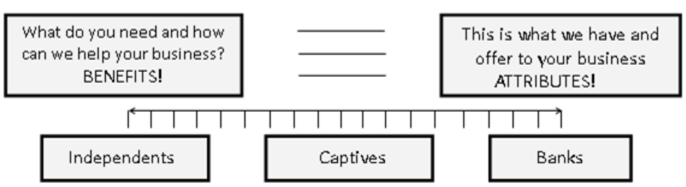
## Delivering Value to the Customer

Independents generally agree that they cannot, nor want to, compete on price. They choose, instead, to compete by meeting other customer needs with value-added services. Banks, on the other hand, lead with price on a standardized product because of scale, regulation, capital access, and other factors. Price gets a customer's attention but generally does not sustain a relationship.

In this respect, according to those interviewed for this study, a polarization of go-to-market styles has occurred in the equipment leasing and finance industry as the business has matured. **Figure 6** shows Independents and Banks at the two poles of market style while Captives tend to be in the middle, although all commentators recognized that there are variations within each of the three types of companies based on circumstances.

Whereas, the scale keeps Captives and Banks toward the Attributes pole of market approach, Independents, with their nimble approach and unique value proposition, sell benefits by focusing on the customer's needs and business. Their brand is their solutions-oriented approach to the customer, not the product (pure financing). In other words, the financing is not an end in itself – it is a means to an end.

**Figure 6**
**Go to Market Approaches**




A key component of its value proposition is the Independent's flexibility in how it relates to the customers' needs and its readiness to change. As one successful Independent executive stated, "Stay very close and evaluate yourself against your competitor's approach to your customer." Independent leasing executives agreed that even with the best customer relationship building, there is not as much loyalty or exclusivity anymore, so constant adaptation is essential.

**The Value to be Delivered to the Customer**

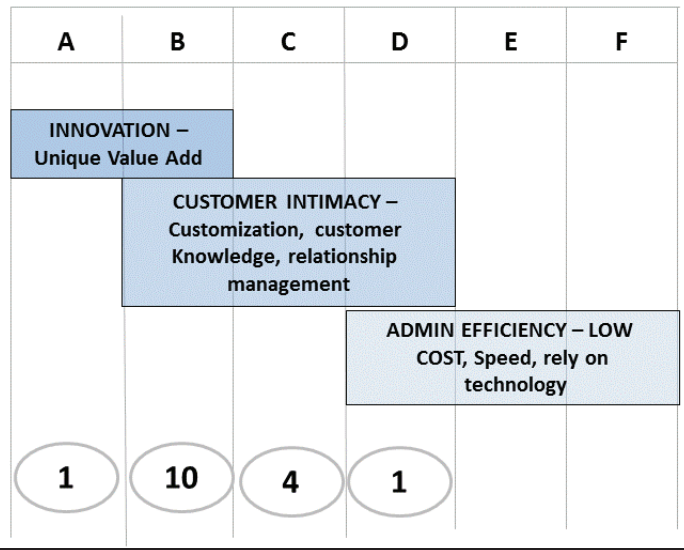
**On scale of 1 (high agree) – 5 (low agree)**

**"Traditionally, Independents tend to be more customer oriented while Banks and Captives tend to be more product oriented."**
**Average 1.4 most frequent 1**

The illustration shown in **Figure 7** reflects the responses of 16 interview subjects to a question exploring the nature of the Independents' market strategy. The illustration is based on Harvard Business school professor Michael Porter's three classic marketing strategies that companies utilize. These strategies include Innovation (a unique value add), Customer Intimacy (customization, customer knowledge, relationship management), and Administrative Efficiency (low cost, speed, reliance on technology).

Respondents in the study selected innovation and relationship management to be at the heart of their market strategy. Based on these responses, administrative efficiency is not viewed by these Independents as central to the strategic core of their business models and value proposition. Administrative efficiency is important to good operations and service, of course, but it is not the lead point. Furthermore, the scale of most Independents neither requires exceptional administration efficiency nor rewards it.

**Figure 7**
**Classic Market Strategies**




Because both flexibility and customization are central to most Independents' value proposition, it can be surmised that processes cannot become too controlling of the business model. This is not to say that administrative efficiency cannot be an important component of the value proposition. A small ticket Independent's strategy, for example, focuses more toward administrative efficiency than those in the middle market. As a rule, however, innovation, customer relationships, and asset knowledge are much more important.

The words that most often sum up the value proposition of Independents are service and relationship. Other descriptors used by Independents in the study include flexibility, speed, reliability, predictability, consistency, solutions, and a total package. For example, one middle-market Independent tells its customers:

> *"You are partnering with us for more than a railcar. You are seeking us out for something no one else provides…a lifetime of success through unparalleled customer service and industry expertise. … Our communication with you guides our path to delivering innovative products and services."*

Another Independent, in a totally different market, states that:

> *"….Rather than offering mass marketed financial services, [the company] has made a commitment to provide the highest level service to a select group of key clients. … We will strive to understand the complexities of your business, your competition, and your industry to provide creative and flexible leasing solutions."*

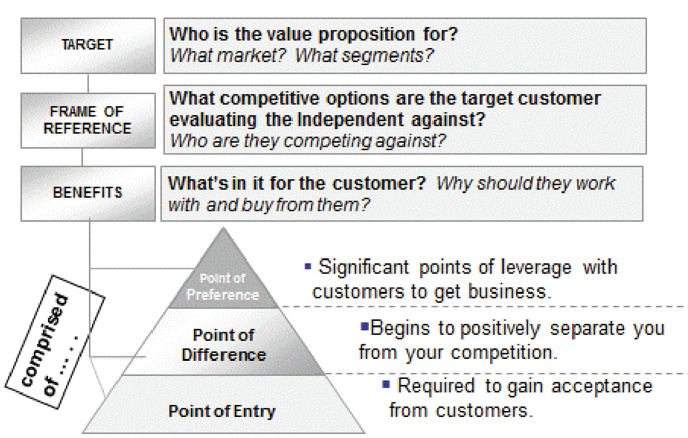
There is consistency among the successful Independents, small and large, in having a tight value proposition and going to market based on it. Other successful Independents have similar value proposition statements and live them, proving this is not just an academic exercise. How, then, does a successful Independent develop, communicate, and live a clearly defined value proposition?

**Figure 8** illustrates both the process and substance for a quality value proposition. How do Independents stack up in this value proposition model?

- **Target?** The Independent needs a market not yet commoditized and into which Banks have not entered in a significant way. The companies are most likely to be SMEs or smaller units of large customers. The channel partner is a customer as well as the end user.

- **Frame of Reference?** Unlike a Bank or Captive competitor, the Independent may not have the reputation or scale to immediately establish a brand reputation with the customer base. Price, due to lower cost of funds or vendor support, is a competitive factor to be considered. A new, or underserved, market may help limit competitive forces.

**Figure 8**
**Components of a Value Proposition**




- **Benefit?** The Independent brings specialized knowledge in the area in which value is to be delivered. It listens to the customer, is flexible, and actively manages the relationship. Service, reliability, consistency, and knowledge are important as differentiators to customers and the customer is willing to pay more for this value.

In establishing its value proposition, the Independent enters at the bottom of the pyramid in **Figure 8**, an area where listening, flexibility, and the ability to share an achievable vision with the customer are highly important. Specialized knowledge combined with an understanding of the customer's situation leads to building the value proposition with the customer.

Successful Independents exhibit discipline in delivering the value proposition. Again referring to Figure 8, as they implement their value proposition they move up the pyramid, focusing on what is core to the value proposition, that which will differentiate them, and establish their brand. The company does not allow itself to try and do too many things, either because doing so detracts from the core message, or it does not have the resources to do so.

As business proceeds, the business practices and relationship begin to differentiate the Independent from its competitors. This stage in developing the value proposition is essential, for if the Independent fails here, it is not delivering on its value proposition and the customer will keep doing business with another company that can deliver what it needs.

Finally, points of differentiation become points of preference for the customer. When a company, whether an Independent or other type of company, reaches the point where it is preferred, it is filling out and living its value proposition. If executed properly, this preference may become an almost exclusive relationship to be nurtured and from which other strong elements of brand, reputation, and repeat business will be built.

Independents also spend a large amount of time with customers as part of their value proposition. Since their business model is generally based on specialization and knowledge of the customer's business, frequent visits are part of the relationship management. This is a one-to-one business process in which asking and listening is essential. By talking to people at all levels of the customer's organization, understanding the business, and validating responses, the Independent allows the customer to co-create the financial solution being offered, which is a winning process.

This value proposition around service, knowledge, and relationship serves the Independent well. For example, speed gets a transaction off the street quickly and integration with the channel partner or customer builds close ties. Being predictable and consistent, combined with the message of "here is what you need" rather than "here is what we have" makes the Independent the champion for the customer in providing the most suitable acquisition financing solution.

It is interesting to compare Independents' product mix to that of all equipment leasing and finance companies in order to gain a better understanding of how Independents differentiate themselves by their value add. **Table Six** compares the percentages of products offered by Independents with the overall, industry use of those products.

Independents offer a larger percentage of single investor tax leases than the industry in general. However, they offer a slightly smaller percentage of operating leases than the industry in general. This latter difference is partially explained by a high percentage of operating leases completed by Captives. Note also that by 2009, 52% of dollar volume of transactions were in loans, either as a finance lease/lease intended for security, conditional sale, or straight loan. For Independents, the 43% share in this area is primarily a reflection of small and micro-ticket, full payout vendor originated transactions.

Much of the equipment leasing and finance volume is originated directly, reflecting the business in larger ticket sizes. Most Independents, however, originate through a mix of vendor/dealer programs, and direct effort. Furthermore, the smaller the ticket size and the smaller the equipment end user, the more likely the origination channel will be vendor based. (As described earlier in this study, ELFA Independent numbers include finance subsidiaries of US industrial companies, primarily GE Capital).

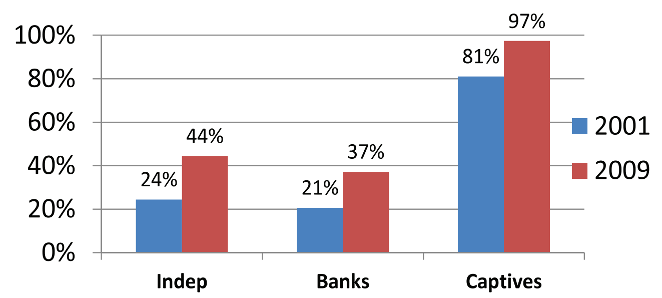
**Figure 9** shows the shift in origination channel for all types of companies surveyed by ELFA. Note that vendor channel originations have increased, meaning that, for many Independents, the customer has become, more and more, the vendor. This trend also is true of Banks and Captives, although it is worth noting that one reason the percentage of direct origination is down, particularly with Banks, is the decline in new business volume in large ticket transactions.

**Table Six**
**Equipment Finance Product Mix**

| Equipment Finance Product | Independents | | All Company Types | |
|---|---|---|---|---|
| | 2001 | 2009 | 2001 | 2009 |
| Single investor tax lease | 32.9% | 34.8% | 25.6% | 26.2% |
| Operating lease | 8.5% | 6.9% | 9.6% | 9.6% |
| Leveraged lease (net equity) | 5.1% | 0.7% | 4.9% | 0.5% |
| Loans /term Loans | 47.1% | 43.6% | 47.4% | 52.0% |
| Synthetic leases | 0.0% | 0.8% | 0.8% | 0.4% |
| Muni/Tax-exempt leases | 1.7% | 5.2% | 2.5% | 5.8% |
| Other investments | 4.6% | 8.9% | 9.3% | 5.4% |

**Sources**: ELA Survey of Industry Activity (2002); ELFA Survey of Equipment Finance Activity (2010

**Figure 9**
**Vendor Channel Originations**




**Sources:** ELA Survey of Industry Activity (2002) and ELFA Survey of Equipment Finance Activity (2010)

Given that the Independents' value proposition is built on service and relationships, how does the place of Independents fit in the traditional business go-to-market concept of Hunters and Gatherers? Alta's observations of the industry and the results of our interviews confirm that Independents primarily are Hunters. For example, every person interviewed, except one, categorized Independents as being Hunters. This says a great deal about the mindset of Independent executives and managers. They are sales and growth-oriented people more than they are process-oriented people.

Independents do not have a network or channel to flow in business as do Banks and most Captives. However, Independents recognize that they must be organized to do both, i.e., hunt to acquire, and then tend the garden. If the value proposition is built around service and customer relationships, tending also must occur after the business is won. The Independent does not just book the business, as there are usually asset management plays, replacements, collections, and additional assets to be financed – all of which require tending.

A major difference for the Independents in this regard, is that, compared with others, the Independent cannot price as a gatherer/gardener. It cannot afford to buy market share, so it has to grow and be profitable on each transaction. The Hunter's characteristics of speed, innovation, hard work, and patience are necessary to success as they go to market.
In spite of a value-added orientation to their value proposition, and the instinct of the Hunter, the place of Independents, in terms of market share, is third. This is not pejorative when viewed in a larger context as observed in data and judged from interviews. As was discussed earlier, large Independents have consolidated to a great extent. The marketplace, however, also has changed in ways that reduced Independents' volumes. Specifically:

- The market has commoditized and become more price-driven, with more secured lending products.
- Customers have changed and become more sophisticated. Market inefficiencies have been reduced, the customers have become more aware, and, therefore, not as many continue to value the services/benefits that come with leases.
- The competition has changed, as Captives have entered the market in a major way and competed head-on with Independents in their space. In addition, foreign bank companies have come into the market, with some large notable ones becoming more important in the marketplace.
- The capital markets have changed, making it more difficult for Independents to raise large amounts of capital.
- Banks and Captives have become better organized. Banks offer a total financial relationship and Captives are good at brand and asset control.
- Technology as a driver for Independents has declined and many cannot manage the asset risks as they once could

Yes, market conditions have changed, along with the funding landscape, but Independents thrive on change. As a classic Stephen Sondheim song goes, "Good times and bum times I've seen them all, and, my dear, I'm still here." Independents are doing well in a different market by delivering value through variations of what they always have offered.

## Making Money

One of the key questions a company considers when deciding how it will make money is whether the revenue model will be volume driven or profit driven. There is no clear consensus as to the answer to this question, as several forces must be considered. For example, why was the Independent created and who are its backers? If the backers are institutional they will expect scale and relevance in the market. If the backers are individuals, including management, the pressure to grow may be less.

Those who believe that Independents should focus on building volume, state that any business must obtain customers and that scale is needed to realize a profit. Without a portfolio and the earnings it creates, profitability cannot be sustained. Furthermore, volume builds credibility with strategic partners such as vendors, funding sources, and customers. Leaders in this position also believe that focus on the bottom line can actually impede growth because of risk aversion. The entrepreneurial spirit discussed earlier requires a focus on volume at the beginning.

There is a sizeable amount of opinion, however, that Independents should focus first on profitability. Credibility requires profitability and, since profitability is more difficult to achieve than volume, it is the important score for sustainability. Furthermore, volume gets attention but it does not add to equity. A veteran Independent executive observed that all lessors, not just Independents, have historically taken more risks than they were paid for, essentially, creating volume without adequate profits. One Independent executive summed up the position by stating that, "There's no glory in volume."

What are the primary sources of revenue in the typical Independent's business model? Interviewees were given nine choices **(see Appendix 5)** and asked to rank the impact of each based on their experience and observations. The top five revenue sources are listed in **Table Seven**, along with the number of 1 – 9 rankings given (ranking scores of 7, 8 or 9 are not included in Table Seven, as there were none that low for the top five sources of revenue).

Although three of the top revenue sources may appear to be the same, or similar, executives interviewed for this study emphasized that residuals, options offered, and asset management are distinct sources of revenue. Each may seem to

**Table Seven**
**Primary Revenue Sources**

| | Rank | | | | | |
|---|---|---|---|---|---|---|
| **Revenue Source by Importance** | **1** | **2** | **3** | **4** | **5** | **6** |
| Residuals | 7 | 4 | 3 | | | |
| Margin/spread | 6 | 5 | 1 | 1 | 1 | |
| Options offered (renewals, upgrades, etc.) | 2 | 2 | 2 | 3 | 1 | |
| Syndication | 1 | | 2 | 3 | 1 | |
| Asset management | 1 | 2 | 4 | | 1 | 1 |

be related to the asset being financed, but the revenue generated from each differs, as they each address, in different ways, what need is being served, or what customer risk or problem the Independent is solving.

For example, the customer may be paying for a particular renewal or upgrade option with regard to the asset, mid-term or even at the end of the lease term. The payment also may be for refurbishing or disposing of the asset, or making available a substitute asset. The revenue even may be as simple as taking a residual position and realizing it upon sale or subsequent re-lease of the equipment. All these features tend to be related to the words Independents embrace – uncertainty, flexibility, service, and customer relationship.

Independents in the middle and large ticket markets tend to focus more on customer knowledge, solutions selling, and relationships. The small ticket Independents, on the other hand, typically make money on margin and through consistent and efficient processes and good relationships. They do not tend to look to options and other asset related services for revenue but, instead serve needs related to speed and convenience.

## Operating the Business

In order to determine Independents' approach to operating the company, study interviewees were asked to indicate their level of agreement with the statement of, "Successful Independents maintain a 'start up' state of mind." On a scale of 1 – 5, with 1 being the highest, several responded with a 3, but most responded with a 1 or 2, indicating a high level of agreement with the statement.

What is a "start-up" state of mind? It incorporates all those factors previously described as fitting into the successful Independent's value proposition – customer focus, flexibility, innovation, and quickness, among others. Successful Independents constantly innovate and push forward, although growth in scale and scope tempers this.

### *General operations*

Despite Independents' emphasis on nimbleness, the sustainable Independent must develop operations, no matter how simple, balancing entrepreneurship and innovation with, "Can we really do this, and, if we can, can we afford to?" With growth comes the need to invest in operations and introduce discipline that policies, procedures, and systems bring. The balance requires that the policies, procedures, systems and structure are built within a culture reflecting the value proposition of the company.

Several observers and commentators of the Independents describe them as life-style businesses, which most likely reflect their leadership. This leadership in turn tends to be independent, alert to respond to new opportunities for sales, pragmatic, flexible, and unstructured. Many believe that the leadership and management style, out of necessity, must keep characteristics of a start-up, as it is the only way to avoid commoditization, which is anathema to Independents.

Independents have had to accept several factors impacting their business model. Customers are smarter and they are better shoppers. This is a classic element of a maturing market or product.

**<u>How the Independent Company Operates</u>**
**<u>Including Capitalizing Itself</u>**

**On scale of 1 (high agree) – 5 (low agree)**

**"Successful Independents maintain a 'start up' state of mind."**
**Average 1.8 most frequent 2**

**"The decline in the number of funding institutions has had the largest impact on Independents of any external reality change."**
**Average 2.7 most frequent 1**

This in turn leads to the decline in certain revenue sources such as residual realization and lease extensions. Even with a distinct and compelling value proposition, the pressures of market maturity and commoditization constantly challenge the Independents' unique market approach.

These market factors have major implications for operations, and its importance. One of the requirements for sustained funding, for instance, is strong business operations - front to back, including systems and technology. In addition, superior operations become an indirect source of revenue as costs related to portfolio management and quality can be managed and even reduced.

Generally, industry executives believe that many Independents have lagged in technology adoption because they could not afford the necessary investment. Also, leadership of Independents traditionally does not focus on strong operations until the realities of their experience dictates that strong operations are essential to sustaining the business. But these same executives stress that technology and adequate systems are the price of admission, if there is to be any scale at all. The many stories of company failures due to inadequate policies, procedures, controls, and systems provide further motivation to implement strong operations.

There are founders of Independents who have built their firms with the intention of eventually selling them as attractive, going concerns. A high valuation for sale requires the existence of strong operations, both in policy and in practice. Independents now pay more attention to auditing and testing their operations for efficiency and effectiveness than in the past, since poor operations lead to lower productivity, higher costs, and smaller profits.

What do Independents do well in their operations? Those interviewed for this study were given a list of eight operational functions and asked to rank them high to low as to what Independents do best. The responses, not surprisingly, are consistent with the Independent business model and value proposition. Below are the functions ranked in order of importance:

- Customer relations management
- Asset management
- Documentation
- Credit underwriting
- Pricing
- Portfolio monitoring and management
- Treasury/funding
- Billing and collections.

Customer relations management was consistently ranked at the top, with nothing else close, as this is the core essence of the Independents' value proposition. The low rating given to the importance of funding was surprising, but many indicated that the real work on funding begins with asset management, documentation, and credit underwriting. Funding management, however, is a key part of operations for Independents, particularly when it is limited or not available

Capital markets innovations over the past 25 years, notably the advent of securitization and private equity, transformed Independents' capital management strategies. Unlike in earlier periods, the number of funding sources is much smaller due to consolidation of Banks. However, the smaller number of funding institutions is not the primary problem today according to those interviewed for this study as, apparently, there is ample funding for good Independent companies that demonstrate a disciplined rigor to transaction underwriting.

***Funding management***

Funding strategy is a continuing and changing process and involves sources, types, terms, cost, leverage, standards, and managing the relationship. With this in mind, how should a quality funding strategy and management for an Independent be developed? Independents must recognize that funding sources have cycles, too, meaning that their willingness and ability to fund comes and goes. Consequently, an Independent needs a funding plan that, at a minimum, addresses the following:

- What will the funding needs be – debt and equity?
- How much equity is available internally to be put into transactions, particularly when residuals are part of the business plan?
- What is the number of debt facilities available?
- What are the credit preferences of each debt facility member?
- How does one keep the longest terms possible for the facilities, avoiding frequent renewals and keeping covenants flexible?
- How does the Independent become and remain important to each source of funding by providing sufficient volume and maintaining close relationships?

Funding begins with equity, as it provides the base on which to leverage debt and build the company's volume and value. The sources of equity include investment by the founders/principals, passive individual investors, private equity sources, and some publicly-traded equity. There are very few public Independent companies today, as being a public company requires a scale that most Independents do not achieve. In addition, the entrepreneurial mindset of some large Independents leads them away from the perceived restrictions that accompany the financial benefits of being public.

Internally developed equity, through retained earnings, also is important and an indicator of strong performance by the company. Equity then is combined with debt at the level deemed appropriate for the company. Industry executives believe that currently, leverage for Independents is best at between 4:1 and 7:1. Lenders and rating agencies become nervous when leverage for Independents gets higher than those levels today

The debt terms should be mixed between short (one year) and longer (three plus years) to allow flexibility to the Independent through potential economic cycles and changes in the portfolio. Independents benefit from a mix of floating and fixed rate debt in order to manage through cycles and their funding sources are primarily banks, both regional and money center.

Large Independents can access securitization and other money market sources. Funding strategies, particularly for larger Independents, also include syndication and portfolio sales to manage the balance sheet, free up capital, and diversify risk. Smaller Independents primarily access bank funding on both a recourse and nonrecourse basis. Working capital lines are common for the typical day-to-day business needs of many smaller Independents, as well as brokering pools of transactions as an alternative funding relief mechanism.

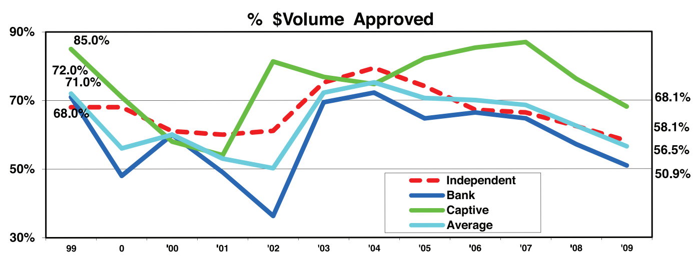
The use of securitization, which benefits leverage ratios and has enabled the growth of some Independents, has been limited in recent years and only is available to larger Independents. In this regard, the performance of secured lending/lease securitizations has been very good, particularly in relation to other financial products utilized in securitization structures.

Some Independents developed a strong reliance on securitization while it was readily available, which may have led them to neglect adequate maintenance of relationships with other funding sources. Liability diversification is important to finance and treasury risk management, as portfolio diversification is to asset and credit management. This liability neglect had a painful result when the access to securitization became restricted or non-existent in 2008. This unhealthy securitization dependency motivated some Independents that had the opportunity to morph into a bank organization to mitigate this capital access gap.

**Figure 10** illustrates a funding-related problem that Independents must address. As financial market and credit underwriting standards have tightened in the past three years, the percentage of approvals has declined for all types of companies. The approval rate of Captives has always been high, but the approval rate for Banks declined to 51% in 2009. This 51% rate represents a tighter market for extending credit. For Independents, whose approval rating declined to 58%, there is a connection to the low Bank approval rate in that most Independents receive a significant portion of their funding from Banks.

Independents take great care to be transparent as to portfolio performance and how they do business. This is accomplished by demonstrating a high demand for credit quality, consistency and predictability, frequent reports, and immediate responses to problems. As to the future for funding, there is cautious optimism that securitization is returning for the stronger Independents, which would be a huge boost to those Independents that could use it. In addition, the generally strong portfolio performance record of the industry coupled with better returns is beginning to attract private equity investors.

**Figure 10**
**Volume Approved as a % of Volume Submitted**




**Sources:** ELA Survey of Industry Activity (1999-2006) / ELFA Survey of Industry Activity (2007) / ELFA Survey of Equipment Finance Activity (2008-2010)

## Determining Scale and Scope

The leadership and management team is the most essential element to achieving the right scale and scope for an Independent. In this respect, forward thinking leadership of Independents frequently challenge their management team with the question, "Can we build what makes us 'us'?"

There is no clear consensus about maximum scale or scope among those interviewed and commentators on the equipment leasing and finance industry. For the most part, as long as the right leadership and management exist and funding can be obtained, scale and scope is not the issue.

The real issue is the same as with realizing any opportunity – growth or expansion of current business requires personnel, systems, and funding.

One industry executive explained in detail the challenge of moving to a new or adjacent niche while stating that an opportunistic business model requires growth in scale/scope. However, the leader must be disciplined to not move unless the business platform for the current segment is solidly working. Entering a new segment or niche while the current business platform is not strong will lead to bad results all around, so Independents would be wise only to expand from a strong base.

Growth and diversity should be planned and studied carefully. For example, how do the Independent's executives and management team think about their company, including its culture? Do they have the vision, desire, and capability to grow bigger and/or broader? Can the value proposition be maintained without any deterioration in margin? At some point, the scale may be large enough to attract competitors that create commoditization or introduce practices that may be undesirable. This is the time to intentionally control segment growth or even consider an exit.

Growth can come from within the scope of current operations or by expanding outside the Independent's current business scope. Another alternative that has seen recent use is to acquire or assemble a team to expand volume or scope.. There appears to be no consensus or data supporting either organic growth or acquisition choices. However, a review of successful contemporary Independents shows that organic growth is the preferred strategy to business or portfolio acquisition.

The reason organic growth is preferred is that acquisition creates issues for Independents that they prefer to avoid. For instance, acquisition requires capital, the scarcest resource for Independents. It also brings a portfolio that may include unknowns even after due diligence, and the integration of acquired entities takes time and can be difficult compared to organic growth. Conversely, acquisition has the advantage of making a strategic move in an accelerated fashion.

Independents have several sources for organic growth. First, they can rely on their current base of business with equipment replacement orders and new orders. This type of growth, which requires innovation, is limited because of concentration risk and the risk that the base may shift and cannot be retained.

Another growth strategy used by Independents is to offer more services to existing base customers, but again, this has limits. Independents also can expand the scope of their business by moving into adjacent markets, defined by different assets or business, in which their value proposition can be applied.

Sustainable Independents state that growth and carefully considered change in scope is essential because of cyclicality in favored assets or economic sectors. A company does not want to depend solely on a market that may be here today but gone tomorrow. At a growing middle-ticket Independent, the executives consider growth areas based on the answer to the essential question, "Do we want to be in that sector?" They take a proactive, rather than reactive, approach to develop areas they believe will be attractive. This approach has become important in establishing the company in several market sectors that may have been overlooked or underserved by others.

Growth in scale and scope does not come with a price, however. It can, for instance, put stress on the entrepreneurial spirit of the leaders or stress the fabric of the company. This explains why some successful Independents reach a level at which they become acquisition targets. At what point does vision and energy max out? This varies but contemporary Independent leaders are conscious of this limitation to scale and scope.

What are the typical ways Independents expand scope outside their current business sphere? **Figure 11** depicts methods with which Independents can expand their scale and scope. Each of these methods is examined in more detail in the following sections.

***Slight imperfections in original segments***

Assume a company is in a niche and serving it successfully, but at some point, the asset financed, the customer, a channel partner, or the market segment experiences some change that affects the way value is created. For example, unique industry factors can, at different points in time, place value on variable payment schedules, payments based on an index, payments tied to customer revenue, or all-in-one pricing for the equipment, supplies, and maintenance.

Tax law or tax liability changes that move a customer into a minimum tax position create an imperfection and may incentivize the customer to move from a loan to a lease. Customers in an industry subject to rate regulation that experiences a change in how allowable or reimbursable costs are calculated also potentially could benefit from a different type of asset financing product. Another example would be when current technology becomes either obsolete or, at best, less efficient. If, however, the asset still has useful value for a small segment of a market niche, the Independent could take advantage of this market imperfection.

***Adjacent segments are developed***

A company may be in a niche that begins to fragment/diversify by customer providers. The fragments are smaller with smaller companies as customers. The small scale, smaller nature of the customer, or different credit standards that often accompany smaller companies, gets the attention of the alert Independent in the core niche. Medical healthcare equipment financing is an example of a niche that continues to fragment by providers and types of medical services from hospitals, to clinics, to small practices, and to specialties.

Other examples include:

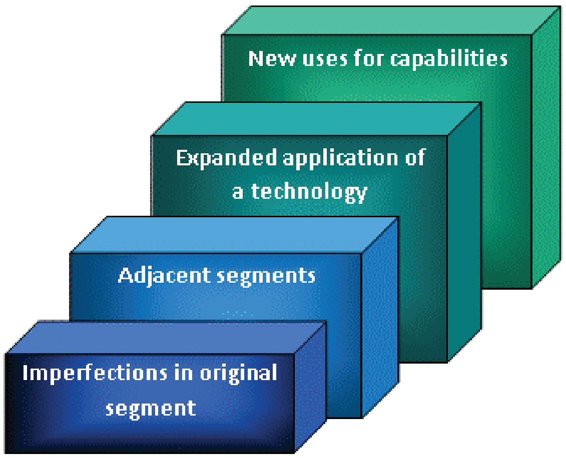
- A Captive that can only do its parent's equipment may need a strategic partner to whom it can refer financings for other brands of equipment in an installation to the same customer.
- A company that finances the equipment for backroom operations may identify opportunities for financing cloud computing/process centers.
- A channel partner sees that risk concentrations need to be spread among several companies with whom it does business.

***Expanded application for a technology***

Technology is constantly changing, which might enable new applications that are regarded as too new by certain competitors. Examples have included copier equipment technology migration from analog to digital, pay for use plans on office and medical equipment, and planned aftermarket equipment uses of a wide array of equipment. Energy niches are examples of expanded applications for technology. Solar as a general topic appears to be a large specialty for an Independent, but niches in solar application are appearing all of the time in ticket sizes from $20,000 to $500,000, a range in which Independents like to do business. Utility vehicles, information and communication systems, lighting, security and electric generation are just a few of the commercial applications that can be financed.

In addition, energy management systems and modern LED lighting systems are in the sweet spot for an Independent. Many of the manufacturers are still too new to commit capital to an internal captive but realize the benefits of sales-assisted financing that an Independent can provide.

**Figure 11**
**Building Blocks for Scale and Scope**




***New uses for capabilities***

Independents have knowledge capabilities and can-do capabilities, each of which can be the base for expansion or combined to provide new sources of value to customers. Knowledge capabilities are what the company knows about a technology, an asset, a market, a customer's business, and how that knowledge can be leveraged. In this respect, Independents can offer system/installation design, life-cycle management, or service contracts. Upgrades and maintenance are common examples of how an Independent's knowledge of the customer, its markets, and the assets can be incorporated in a plan to keep the customer's operation at the level the customer desires.

Can-do capabilities include doing things for others that they cannot do or do not want to make the investment to do. The most common example is offering the excess capacity of a backroom to other smaller companies or companies that need the special business processes that go with a particular market. Can-do capabilities also include activities around asset management.

As Independents with sufficient scale and scope grow, they also discover other non-finance services that can be performed for channel partners or end user customers. These include carrying out certain processes such as asset inventory management, CRM systems, and accounts payable or receivable.

Executives interviewed were mixed in their opinion about the two recurring factors obviously necessary for growth in scale and scope – management and funding. Executives, however, are not optimistic that the required leadership and management exist among a large number of Independent companies, as leaders in Independents do not have an institutionalized career path to develop capabilities, which is limiting in terms of scale.

Availability of capital is the second factor limiting the growth of Independents. Sources of capital are being asked to make big commitments based on the strength of a business model, value proposition, asset types, sectors, economic cycles and more. The larger and more diverse the company, the more the funding must be managed. The funding strategy has to include diverse sources for diverse types of sectors/segments, assets and types of transactions as growth occurs.

## Leading and Managing

In the *Perfect Storms* study conducted by The Alta Group for the Equipment Leasing & Finance Foundation in 2001, Independents represented three of the ten company failures that were specifically studied. These Independents failed because the leadership and management made errors of omission or commission. Two grew but did not maintain adequate controls to monitor performance. The third decided to radically change its business scope into an area for which it was not prepared and, in the process, abandoned its core value proposition that had sustained its success for decades. The lesson here - leadership matters!

Themes that emerged in the current study are that the sustainability of an Independent relates heavily to its leadership and management and that Independents tend to reflect more entrepreneurship in their leadership and management. Furthermore, this entrepreneurship is at the core of the thinking and culture of the entire company

As size grows, the center of entrepreneurship has to shift. While a company is small with few employees and a limited market and customer focus, the center of entrepreneurship must be squarely in the top executives. But with growth and diversity, entrepreneurship relocates institutionally to another place or places in the company to keep it alive and close to business implementation. This other place might be a business development unit or a research and development unit. The conclusion here is that every effort is made to institutionally keep entrepreneurship central to the company's value proposition and future.

For Independent executives, it is even more important to nurture the entrepreneurial culture without micro managing. Effective strategy and strategic implementation requires goals, standards, timetables, evaluation, and constant communication and involvement among the responsible parties - bottom to top and back down. "Incentivize what is important and keep fear out of the management style," is a frequently heard comment from successful Independent leaders.

## Conclusions

With high quality leadership and management as a universally critical component of the successful Independent, The Alta Group believed that as part of this study it not only should interview a large number of people and review a great deal of data, but also select five companies that - by most definitions and reputation - are successful Independents. Two are technology oriented. In terms of ticket size - three are middle-market oriented and two are small ticket oriented. In terms of origination channel, two are vendor channel oriented, one originates on a direct basis and two are mixed direct and vendor. The concepts related to successful Independents and their place in the equipment finance and leasing business as developed in this study were applied to what is known of how these five companies go to market and operate. No proprietary information on the companies was used in this study. The objective was to apply the description of *The Place of Independents* and validate what makes sustainability and success against these companies for testing and validation. Each of the companies has been in business for a minimum of seven years and some much longer. Each of the companies is in the Monitor 100™. As their respective names have not been disclosed, their identities are not important to the purposes or conclusions of this study.

The study acknowledges that there are many Independents that are small players in the market and have sustained while other Independents have failed. In general, what sets successful Independents apart from other Independents or other types of equipment financing companies is not power in the marketplace. But The Alta Group believes that for a study of this type, only Independents that have sustained a recognized market presence, growth and been relevant to the market over time could be exemplary. In the same sense, finance subsidiaries of large industrial companies play an important role in the equipment finance market but they are not examples of Independent companies.

With the above stated, here are the conclusions drawn regarding *The Place of the Independent Lessor*:

1. Success in equipment finance and leasing for Independents is strong because they serve important niche markets of select customers and channel partners. The market penetration rate of overall new business volume may be small but the nominal amount is material.

2. The number of Independents that are material in the marketplace, as measured by inclusion in the Monitor 100™, is declining.

3. Independents must establish and manage a sustainable funding program to provide capital as essential to sustained success. Capital markets are the single most important external factor for Independents.

4. Executive leadership and management are the most important internal differentiators for sustained success. Leadership and management make the decisions related to the six questions (discussed in this paper) that must be addressed and then lead the execution. Some may question that this is a strong concluding statement. In extensive discussions, however, the statement is repeatedly validated by results. Objectives achieved, sustained competitiveness, good performance metrics and maintained relationships are not accidents. Leadership and management are the only internal variables that result in success over time. Success is not an accident.

5. Development and execution of the right *Value Proposition* is essential. *The Value Proposition* answers, “Why do business with me?” It unifies the organization and guides execution. It tells the organization why it is in business and how it will measure success.

6. The common differentiating elements for Independents’ marketing strategy and *Value Proposition* are adjusting to opportunity, flexibility in delivering value, innovation and intimate customer relations.

The Place of Independents has been and will be a good place for the right companies. How many right companies are there? That is a decision the market eventually makes for all companies in all businesses. Independents have a good future, even if the marketplace in which they can successfully compete is in the $5 to $7 billion in annual new business volume range. Given the more modest size of the typical Independent, this market provides relatively high volume potential. Beyond this space, the Independent enters a market arena already occupied by a much larger group of well entrenched Bank and Captive operators and characteristically more commoditized pricing.

New Independent entrants can find success. Several new companies are forming with experienced teams as funding becomes more available. Consolidation has resulted in good executive leadership and management becoming available. There are examples of the latter including previously successful Independents who had "cashed out" but now see renewed opportunity.

Regardless of the business being studied, equipment leasing and finance or otherwise, the ultimate path to success is the right *Value Proposition* executed by capable executive leadership and management.

# Appendix

## 1. Common Definitions Applied in the Study

This study is focused primarily on the US equipment finance industry and focused on one specific type of lessor: the Independent Lessor, in contrast to the other types of lessors. While these organization types are commonly understood within the equipment finance industry, they are defined here.

- Independent Leasing and Equipment Finance Company (or "Independent"): This lessor type is often the "catch all" category for all leasing companies that are not Banks and are not Captives. However, for purposes of this study, our focus will be upon the Independent Lessor subset that specifically is publicly or privately held;
  - Maintaining their own treasury function to raise capital;
  - Holding more than 50% originations as receivables on the books;
  - Neither owned nor controlled by a Bank, Equipment Manufacturer or Industrial Company (though it can be partially owned by an outside entity);
  - Characterized by value delivered to customers by managing risks and providing non-financial benefits as well as maintaining a close relationship;
  - Not in the position of having a safety net for the enterprise – a parent or government guarantee, and,
  - Unregulated by banking authorities.
- Bank Lessor (or "Bank"): This is the leasing subsidiary or division of a commercial bank, comprised of both U.S. domestic banks and international banks operating in the U.S. Where available in this study, this bank lessor data is separately delineated between domestic and international. Transaction funding is primarily provided by the parent Bank.
- Captive Lessor (or "Captive"): This is the leasing subsidiary of a manufacturer that provides financing for the equipment made and sold by the parent company. Funding for originated transactions is primarily provided by the parent or through the parent's treasury operations.
- U.S. Industrial Company Finance Subsidiary (or "Industrial"): This is the subsidiary of a U.S. industrial company that is active in equipment leasing. While in some surveys this lessor type is combined with the Independent Lessor; however, there are distinctive go to market and operating characteristics that make this important to delineate. Funding for originated transactions is primarily provided by the parent or through the parent's treasury operations.
- Broker or Investment Banking Company: This lessor type is often a lessee advisor or acts as an intermediary – sometimes temporarily funding transactions, staging them in a warehouse facility for subsequent placement. (As these transactions are ultimately funded and held by others, this lessor type will not be extensively referenced in this paper.)
- Not Elsewhere Classified (or "NEC"): This lessor type includes companies that predominantly use income funds or other off-balance-sheet vehicles as capital and equity to provide transaction funding. (This lessor type has a limited population and will not be extensively referenced in this paper.)

## 2. Methodology

The Alta Group has undertaken a four-pronged approach to conducting this study.

A. **Quantitative:** Alta utilized the extensive database of the Equipment Leasing and Finance Association (ELFA) and the resources of **The Monitor** in their annual spring rankings published as **The Monitor 100™** to study and present data illustrating and analyzing the following data points of *The Place of Independents* in the marketplace over time:
- Annual New Business Volume in nominal terms and as a percentage of the whole over time.
- Changes in financing product mixes over time.
- Changes in ROE.
- Changes in asset / transaction size / origination sources and other market changes over time.
- Funding costs.
- Changes in relative positions of Independents, Banks and Captives.

B. **Qualitative Interviews:** The Alta Group conducted interviews of veteran and contemporary executives of leading Independent companies. The interviews were based on a set of common questions developed by Alta. *(See Appendix 5.)* Responses are anonymous but were compiled in a manner that permits selective tabulation and comparisons, as well as demonstrates both consensus and differences.

C. **Quantitative/Qualitative Application:** As The Alta Group prepared this study, it used a selected group of five diverse current and successful Independents (to be kept anonymous) against which the comments, findings and conclusions regarding *The Place of Independents* and what makes an Independent successful could be applied for testing and validation purposes. For example, observations and findings about selecting segments, strategy setting, execution or funding were evaluated in terms of what Alta knows from observing and working with certain sustained and successful companies.

D. **Trend Synthesis:** The final component of the study is a synthesis of quantified data trends and conclusions with the results of the extensive interviews. This synthesis was used to achieve the conclusions of the project and discuss these conclusions in terms of a prescription for sustainable success by Independents in the future.

## 3. Primary and Secondary Information Sources

Information in this study comes from a variety of valuable sources. These sources are qualitative and quantitative, current and historical. Descriptions and practices are placed in the context of accepted business academic theory and best practices where possible.

- Interviews of industry leaders. Principals of The Alta Group interviewed 19 experienced and respected industry executives with extensive successful experience either as Independent executives or working directly with Independent companies. These interviews averaged 90 minutes in length and were done based on a set of questions provided to all prior to the interviews. The interviews were done independently either in person or by telephone. *(See Appendix 4 for list.)*
- ELFA Survey of Equipment Finance Activity (and the survey via its predecessor names) beginning in 1988.
- Statistics and charts from the *Monitor* used in compiling the Monitor 100™ which commenced in 1992 (for fiscal years 1991 and forward).

## 4. List of Individuals Interviewed for the Study

| Name | Company |
|---|---|
| Laird Boulden | Heller; Tygris |
| Bruce Bowen | Multiple; ePlus |
| Aylin Cankardes | Multiple; Rockwell |
| Ed Cherney | Multiple; TIP |
| Dan Dyer | Multiple; Advanta; Marlin |
| Henry Frommer | Charter Commercial Funding; Wells Fargo |
| John Giddens | USL Retired |
| Tony Golobic | GreatAmerica Leasing |
| George Kilroy | PHH Arval |
| Joe Lane | Multiple; GATX |
| Jim McGrane | Heller; Tygris; EverBank |
| Paul Menzel | Multiple; Financial Pacific |
| Debbie Monosson | Boston Financial & Equity Corporation |
| Jim Possehl | Republic Finance |
| David Schaefer | Orion First Financial Corporation |
| Ken Steinback | CSI Leasing, Inc. |
| Bill Verhelle | First American Equipment Finance |
| Rick Wolfert | Multiple; Heller; Tygris |
| Paul Zediker | First Bank of Highland Park |

## 5. Discussion Questions Used with Interviewees

**Section 1 - The customer and market niche(s) selected**

1. Over time, how has market sector selection changed for Independents based on external changes such as technology, tax policy, shifts in economic conditions and changes in competitive environment? Examples?

   On a scale of 1 – 5, 1 being highest – your level of agreement with the following statement: "Changes in equipment technology have provided the single biggest opportunity for Independent Companies."

2. What four words / phrases best describe the types of markets and customers sought by Independent companies?
3. Do Independents tend to have a narrow / specialized focus more than Bank or Captive lessors? Why? Why not?
4. What process / system (if any) do Independents use to look ahead and vision where they want and need to be to sustain their business? Does this process differ from Banks or Captives?

On a scale of 1 – 5, 1 being highest – your level of agreement with the following statement.
"Independents tend to be more intuitive than structured in their approach to looking ahead and visioning than Banks or Captives."

5. How do you react to this statement? "Independents are drawn to emerging sectors rather than mature markets." Why or why not?
On a scale of 1 – 5, 1 being highest – your level of agreement with the following statement.
"Independents are drawn to emerging sectors rather than mature markets."
6. How do you react to this statement? "It is easier to be an entrepreneur in a small sector than a large sector." Why or why not?

**Section 2 – The value to be delivered to the customer**

1. How do you react to this statement? "Independents tend to focus more on what customers / channel partners need than on the financing product that the company has / wants to offer." If you tend to agree, has this always been the case?
On a scale of 1 – 5, 1 being highest – your level of agreement with the following statement.
"Traditionally, Independents tend to be more customer benefit oriented while Banks and Captives tend to be more product oriented."
2. How do Independents tend to identify the needs of customers / channel partners?
3. What type of "value" that satisfies customer needs are Independent lessors most able to deliver compared to their competitors?
4. On a scale of 1 – 5, with 1 = Hunter and 5 = Gatherer, where would you grade the typical Independent? Why?
5. What four words or phrases come to your mind to describe the shift in market penetration / power among the Independents, Banks and Captives over time? Elaborate.
6. Review Figure 1 below. Which letter column best represents the marketing strategy of Independents? Elaborate.

**Section 3 – How the Independent company makes money**

1. How do you react to this statement? "Independents tend to focus more on building volume than on profit / cap value in the early years of the company."
2. Generally speaking, rank order the importance of each source of revenue to an Independent's success (competitive and profit) 1 – 9, 1 being highest.
   a. ____Margin / spread
   b. ____Residuals
   c. ____Options offered to customer / channel partner (e.g.: upgrades, substitutes, life-cycle programs, renewals and extensions)
   d. ____Packaged services related to the asset financed (e.g.: software, maintenance, supplies).
   e. ____Syndication / arbitration.
   f. ____Tax liability management
   g. ____Acting as an outsource for variety of services / processes.
   h. ____Asset management.
   i. ____Other.

**Section 4 – How the Independent company operates including capitalizing itself**

1. How do you react to this statement? "Leaders in Independents keep the mindset of an entrepreneur of a startup company?" Agree? Why or why not?
On a scale of 1 – 5, 1 being highest – your level of agreement with the following statement.
"Successful Independents maintain a 'start up state of mind'."
2. How do you react to this statement? "The decline in the number of funding institutions has had the largest impact on Independents of any external reality change." Why or why not? What other external changes have had a major impact.
On a scale of 1 – 5, 1 being highest – your level of agreement with the following statement.
"The decline in the number of funding institutions has had the largest impact on Independents of any external reality change."
3. How do you react to this statement? "Independents have been slower to implement strong front to back operations technology." Agree or disagree – why or why not? Examples.
4. What do Independents do best in their operations? Rank order the following 1 through 8 with 1 being the best:
   a. ____Pricing.
   b. ____Credit underwriting.
   c. ____Documentation.
   d. ____Portfolio monitoring and management.
   e. ____Treasury / funding.

f. ____Billing and collections.
g. ____Asset management.
h. ____Customer relations management.

5. Describe how the funding process must work for non-public Independents to be sustainable.

**Section 5 – The Independent company's sustainable scale and scope of business**

1. How do you react to this statement? "There is a maximum scale and scope for an Independent before sustainability becomes very difficult."
2. What are the biggest problems associated with growth for Independents? Provide three words or phrases.
3. What can make an Independent an excellent origination platform for Bank or Captive? Provide three words or phrases.

**Section 6 – General Questions regarding leadership and strategy**

1. How do you react to this statement? "Independents tend to reflect more entrepreneurship in their leadership and management." Agree / disagree – discuss.
2. How can / does an Independent executive be an entrepreneur in a mature business?
3. How does an Independent executive engage all staff in innovation and transformation compared to non-Independent companies?
4. How do you react to this statement? "Compared to Banks and Captives, Independents must understand and manage all risks better to sustain their business." Why or why not – discuss?
5. Use three words or phrases that describe what gives Independents competitive power in the marketplace.

## 6. Bibliography

**Monitor 100 Survey Data**

| Issue | Issue Date | Volume / Issue | FYE | © |
|---|---|---|---|---|
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| 1995 Monitor 100 | May/June, 1995 | Volume 22 Number 3 | 1994 | © 2010 Xander Media Group, Inc. |
| 2000 Monitor 100 | June, 2000 | Volume 27 Number 6 | 1999 | © 2010 Xander Media Group, Inc. |
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| 2010 Monitor 100 | Monitor 100 Issue | Volume 37 Number 4 | 2009 | © 2010 Xander Media Group, Inc. |




**ELFA Survey of Equipment Finance Activity Data**

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While Alta has separated the data where possible, a number of the referenced surveys group all lessors that are not Banks or Captives as Independents, including industrial company finance affiliates. Consequently, some of the data presented may include industrial companies, such as GE Capital, even though these companies do not fit Alta's study definition of Independents as described in the Preface.

David Schaefer, Ken Steinback, Bill Verhelle, Rick Wolfert and Paul Zediker, who graciously consented to participate in an in depth interview and discussion related to *The Place of the Independent Leasing and Finance Company.*

## 8. About the Researchers

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As President of the Equipment Leasing and Finance Association (ELFA) for 27 years until 2006, Michael J. Fleming provides a very unique, forward-thinking perspective on the equipment leasing and finance industry. His extensive experience and expertise in organizational strategy, strategic marketing and advocacy combine with unparalleled contacts and a range of resources throughout the industry in both the United States and abroad. Michael assists clients in strategic consulting, leadership development, market and competitive analysis, unilateral and multilateral projects.

**David S. Wiener**
*Director, The Alta Group*

David Wiener has been active within the equipment finance industry for more than 30 years in capacities ranging from credit and pricing to sales and capital markets syndications. A respected authority on equipment finance demographics. David participated for 24 years on the Equipment Leasing and Finance Association (ELFA) committee that oversees design and review of the Survey of Equipment Finance Activity benchmarking report, chairing it for 16 years. He has also been instrumental in commissioning more than 40 major industry reports on behalf of the industry.

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