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By William Tokash

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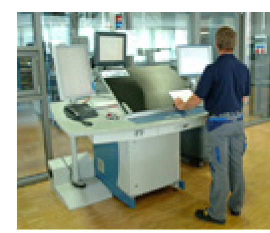
Independents: Niche Focus for Continued Success

By Charles Wendel

Despite multiple challenges, Independents of various type and size have continued to thrive and even dominate some sectors. These challenges include cost-of-funds disadvantages, increased focus by some banks on equipment finance, rising IT costs, and the downturn of the early 2000s. Based on a Foundation study, this article highlights the current role of Independents, how they have evolved since 2011, and their potential evolution over the next five years.



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The electric power industry is facing a fundamental shift from centralized power generation toward more renewable energy and a decentralized grid known as the "energy cloud." The energy cloud consists of a mix of renewables, distributed energy resources (DER) technology, and smart grid software solutions. This combination promises to disrupt traditional utility electricity procurement and power delivery models while creating new opportunities for energy users.

From a utility customer perspective, corporate commercial and industrial (C&I) energy and sustainability managers historically have had little say about the price and type of electricity they procure under traditional, regulated, and centralized grid models. These C&I energy users will increasingly seek cost-effective, customized, and property portfolio-wide comprehensive energy management solutions that go beyond traditional energy efficiency upgrades.

The most sought-after solutions over time will provide C&I energy users with guaranteed energy use reduction and cost savings without capital expenditures (CapEx) to meet their sustainability and operational efficiency needs. These new, financed integrated energy efficiency and intelligent buildings-based DER solutions shown in Table 1 will give rise to the energy as a service (EaaS) marketplace.

Navigant Research anticipates that the emergence of the power sector and customer factors outlined in this article will give rise to demand for innovative financing options for C&I energy users to avoid CapEx expenditures. Financing innovation will sit at the heart of the EaaS segment, to enable new business models and the delivery of new customer options. The emerging DER financing opportunities, risks, and opportunities discussed in this article are examined in greater detail in the recent Foundation research report on which this article is based.

Table 1. New, Integrated Energy Efficiency, Intelligent Buildings-based EaaS Solutions

Portfolio advisory services	▪ Strategic portfolio guidance ▪ Portfolio benchmarking ▪ DER technology feasibility, real-time EM&V ▪ DER financing models
Energy efficiency and building optimization	▪ Lighting retrofits ▪ Energy savings performance contracting ▪ C&I EE retrofits & energy management ▪ Building optimization and retrocommissioning
Offsite energy supply	▪ Offsite wind, solar PV procurement ▪ Retail choice energy procurement
Onsite energy supply	▪ Onsite solar PV ▪ Combined heat and power ▪ Onsite diesel and natural gas gensets ▪ Microturbines, fuel cells
Load management and optimization	▪ DR capacity market participation ▪ Energy storage, microgrids, EV charging ▪ Intelligent building analytics and controls

Source: Navigant Research.

Editor's note: This article is based on a Foundation research report titled The Impact of New Energy Production Technologies on Equipment Finance, *published in January 2019. It is available at www.leasefoundation.org.*

Navigant Research anticipates that, by 2030, up to a 50% reduction in demand for large, centralized power-generating plants on transmission and distribution systems is possible.

ENERGY AS A SERVICE SOLUTIONS

Onsite solar photovoltaic (PV), energy storage, electric vehicle (EV) charging, and other DER technologies are being deployed on C&I energy users' properties using new financing instruments. Driving the emergence of EaaS solutions are financing instruments including equipment leases, power purchasing agreements (PPAs), and software and equipment subscriptions. These new EaaS solutions, which transcend traditional project-based energy efficiency EaaS solutions, include:

- **Portfolio advisory services:** Comprehensive strategic guidance to navigate the unique procurement, energy management, sustainability, financing, business model, and technology opportunities, often provided as a separate fee for service, but increasingly provided as part of a bundled, financed solution alongside other solutions below.
- **Onsite energy supply:** Onsite distributed generation solutions like solar PV, combined heat and power (CHP), diesel and natural gas gensets, microturbines, and fuel cells.
- **Offsite energy supply:** Electricity procurement options from offsite sources in competitive electricity and gas supply markets and from new emerging large-scale, offsite renewable energy procurement business models.
- **Energy efficiency and building optimization:** Comprehensive energy efficiency assessment, business case analysis, financing, implementation, monitoring and verification, and building commissioning services.
- **Load management and optimization:** Comprehensive management solutions to optimize energy supply, demand, and load at an enterprise-wide level, including demand response (DR), distributed energy storage, microgrid controls, EV charging equipment, and building energy management, analytics, and controls.

Navigant Research defines EaaS solutions as follows:

> The management of a customer's energy needs across its portfolio of properties — such as portfolio strategy, program management, energy supply, energy use, and asset management — by applying new products, services, technology solutions, and both project and enterprisewide financing instruments that avoid customer capital expenditures while reducing energy use, spend, and risk.

The confluence of new DER solutions availability, when combined with financing innovations leading to new business model development under the EaaS umbrella, has the potential to disrupt the traditional utility business model and to open new opportunities for energy service companies to respond to customer demand for energy solutions that are clean, distributed, intelligent, and mobile.

FINANCIERS NOW LOOKING TO SUPPORT EAAS SOLUTIONS

While the energy transformation and customer needs are combining to create the demand for new financed EaaS solutions, traditional energy project financiers are also facing new challenges. Considering both new demand for electrification and demand reduction associated with the growth of DER, Navigant Research anticipates that, by 2030, up to a 50% reduction in demand for large, centralized power-generating plants on transmission and distribution systems is possible.

This trend is driving energy project finance investors to look beyond traditional fossil fuel-based coal and natural gas centralized generation and large-scale renewable energy project finance investment instruments, driving them to new DER solutions. However, the deployment of financed DER solutions on C&I energy users' properties, which can provide both customer and grid optimization benefits, will be undertaken across increasingly complex use case scenarios.

This is new territory for most energy sector project finance investors. For the first time, many of them are examining the risks associated with these types of investment.

Third-party solutions providers will increasingly need to deliver a full set of integrated financed DER solutions across portfolios of C&I energy users properties. Solutions include onsite energy supply and load management solutions. Key enabling factors are the integration of energy efficiency, offsite energy supply, and intelligent buildings analytics and controls.

This evolution portends increasingly complex interactions between building-load and tariff-specific energy, demand, and time-of-use (TOU) charges and the operation of onsite energy supply, energy efficiency, and load management technology.

To support the growth of DER financing at stand-alone C&I facilities, this interaction will require increasingly sophisticated pre-project analytics, operational control, and optimization capabilities across intelligent building-enabled DER software platforms.

Specifically, C&I energy users will increasingly seek proven, investment-grade DER technology partners and balance sheet-backed project delivery vendors that can guarantee energy and cost savings through innovative DER financing. Navigant Research anticipates that the continued growth of DER project finance asset classes will be required for solutions that go beyond stand-alone energy efficiency to support the need for deployment of customer-sited DER at C&I facilities without CapEx.

INNOVATIVE EAAS FINANCING EXAMPLES

The following three projects highlight innovative financed EaaS solutions that have recently been delivered to the C&I energy user segment.

Metrus Energy Efficiency as a Service Agreement

Many C&I energy users face internal challenges when trying to reduce their energy use and spend. Two challenges are their hesitancy to deploy their own capital for noncore operations (such as energy management) and their capital expenditure payback expectations, which are often too short for energy management. Many of these same customers are also hesitant to sign the kind of long-term EaaS financing agreements that eliminate these CapEx and payback challenges.

One solution that is helping to overcome these hurdles is the efficiency as a service agreement (ESA) being offered by Metrus Energy. Metrus Energy's ESA is analogous to a solar PV power purchase agreement, in the sense that sources of private capital are used within a project finance instrument. However, in an ESA, service payments by the C&I energy user are based on actual avoided kilowatt hours (kWh) of electricity or therms of natural gas. The ESA allows for the C&I energy user to transfer the risk related to project design, execution, and performance monitoring to Metrus and its network of project deployment support partners.

According to a recent project announcement, Metrus Energy is executing a $5 million ESA transaction over a four-year term with a Fortune 100 technology customer. This project is part of a rollout of LED lighting and building management system (BMS) upgrades at multiple sites in two separate states. Metrus has now financed more than $41 million under this customer's ESA program, resulting in over one billion kWh of energy savings.

Efficiency as a service offerings like Metrus's avoid capital outlay from the C&I customer, allowing for the transfer of project execution risk. Such EaaS offerings — performed under a short-term agreement as part of an ongoing, repeatable series of projects across a C&I energy user's portfolio — are exactly the kinds of solutions for which C&I energy users are looking.

Shell New Energies GridPoint Sparkfund Technology Subscription Partnership

One key challenge for these C&I customers is to provide the right mix of financed solutions such as energy efficiency, solar PV, energy storage, demand response, microgrid technology, intelligent building platforms, and EV charging infrastructure. For example, deploying a mix of solutions complicates the potential for predictable energy savings for the customer.

And now, with the move away from centralized generation, traditional energy sector project financiers are looking to integrate these project components for the first time to meet these customer needs.

An example of this type of integrated solution delivery is represented by Shell New Energies' recent announcement of a new business model approach called Shell Energy Inside.

Shell Energy Inside represents an innovative approach to bundling EaaS solutions, both to avoid customer CapEx and to better manage energy across a new business model. Specifically, Shell Energy Inside will leverage Grid Point's Energy Manager, a smart buildings energy management and controls platform, to the end of making bundled energy management solutions available to customers as a monthly subscription through Sparkfund's SparkOS technology subscription platform.

Shell Energy Inside's new partnership represents a bundled,

Many C&I energy users face internal challenges when trying to reduce their energy use and spend. Two challenges are their hesitancy to deploy their own capital for noncore operations (such as energy management) and their capital expenditure payback expectations, which are often too short for energy management.

commercial buildings-focused energy as a service business model to deploy analytics, HVAC and lighting upgrades, energy storage, electric vehicle charging, advanced building controls, retail power supply, and demand response across a single operating expense payment.

NantEnergy SmartStorage®

The C&I distributed energy storage system (DESS) market is defined by battery energy

Although these solutions can create customer value, the payback for the deployment of these systems often exceeds the one- to two-year CapEx return on investment expectations of many C&I energy customers.

storage systems that are installed behind the customer meter at C&I buildings to provide a variety of energy management services. These services can include having the DESS:

- respond automatically to building-load changes to reduce tariff-specific electricity demand charges relative to the customer's load profile,
- manage battery charging and discharging protocols and tariff-specific electricity rates, to provide time-of-use energy cost savings,
- maximize the consumption of onsite solar PV generation to reduce tariff-specific energy and demand-charge savings, and
- provide backup power and improve power quality to protect sensitive equipment from power- quality fluctuations and outages, to ensure operability during grid outages.

Although these solutions can create customer value, the payback for the deployment of these systems often exceeds the one- to two-year CapEx return on investment expectations of many C&I energy customers. NantEnergy, which recently acquired Sharp Electronics Corp.'s Energy Systems and Services business, leverages a series of financing options:

- NantEnergy's SmartStorage® systems can be leased under a 10-year asset management agreement that includes a 10-year performance guarantee. If guaranteed demand reduction savings are not met, NantEnergy will compensate the customer for peak demand costs that were not avoided. These 10-year asset management agreements include operations and maintenance. Potential system downtime is covered by the performance guarantee.
- NantEnergy's SmartStorage® systems can also be deployed with solar PV systems under a leased solar-storage asset management solution that includes the asset management services outlined above and a demand-charge reduction performance guarantee.

With financing options that avoid CAPEX deployments, NantEnergy's innovative financing approach is well positioned to enable C&I customers to deploy and install these systems.

CONCLUSIONS

The following takeaways underpin the move toward more financed distributed energy resources solutions being provided under the EaaS banner at commercial and industrial energy user properties:

- C&I energy users seek balance sheet-backed vendors that can guarantee energy and cost savings through innovative DER financing offerings. This need shifts the challenge to DER deployment away from CapEx — which is less favorable from an accounting perspective due to financial balance sheet implications — and toward service contracts categorized as an operating expense (OpEx), which do not have financial balance sheet implications.
- Traditional energy sector project finance investors will increasingly look beyond traditional fossil fuel-based coal and natural gas central generation and large-scale renewable energy project finance investment instruments. These new investors will seek new EaaS solutions to address the anticipated reduction in centralized generation demand. Consequently, they are looking more closely at the risks and cash-flow predictability of financed DER projects as part of new EaaS solutions.

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Independents: Niche Focus for Continued Success

By Charles Wendel

Despite multiple challenges, Independents of various types and sizes have continued to thrive and even dominate some sectors. These challenges include cost-of-funds disadvantages, increased focus by some banks on equipment finance, rising IT costs, and the downturn of the early 2000s. Based on a Foundation study, this article highlights the current role of Independents, how they have evolved since 2011, and their potential evolution over the next five years.

Independents remain a strong and critically important segment of the equipment finance and leasing industry. All signs point to their continuing to play a vital role going forward, no matter the business environment. The most successful players will adapt to changing circumstances, finding niche opportunities to meet customer needs while achieving strong returns.

Most Independents will continue to avoid direct competition with Captives and Banks, instead focusing on niches and customer types with which they can demonstrate value. The future is never certain, but Independents have demonstrated their ability to consistently generate strong returns.

FIC Advisors recently completed a report for the Equipment Leasing & Finance Foundation that involved assessing Independents' recent economic performance and interviewing more than 20 industry leaders concerning their day-to-day challenges as well as future expectations. This work enabled us to look at past results and to develop a perspective on why the industry succeeds today and how it has positioned itself for the future.

ECONOMICS: GROWTH, STRONG RETURNS, AND PRICING FOR RISK.

Based on ELFA's Survey of Equipment Finance Activity (SEFA), over the past 20+ years, Independents' share of total new business volume (NBV) has declined from a high of about 70% in the mid-1990s to 4.6% in the most recent year.

A second survey, the Foundation's 2018 Equipment Leasing & Finance Industry Horizon Report, based on end-user customer interviews rather than ELFA members, estimates Independents' NBV share at 16%.

An observer might say that any industry seeing share erosion from 70% to 5% is fighting for survival and relevancy. But there are myriad reasons for the share decline, some of which result from the attractiveness of equipment finance overall as well as individual companies.

The reasons for the share decline include:

- Industry consolidation due to Banks acquiring Independents.
- Increased Bank focus on equipment leasing as both a lead and cross-sell offer.
- The inability of weaker or smaller Independents to maintain the required funding sources during the downturn.
- Changes in classification. SEFA respondents classify themselves as Banks, Captives, or Independents. In years past a number of companies, including CIT, DLL, and GE Capital, reclassified themselves from Independents to Banks or Captives, reducing NBV for the Independents' segment. The reclassification in part resulted from CIT becoming a bank to ensure its survival post-Great Recession and in part from the dismantling of GE Capital, with many of its noncaptive businesses sold mostly to banks.

Data from the Horizon report also helped to quantify the

Editor's note: This article is based on a Foundation research report titled Independents: Banking on the Non-Banks, *published in February 2019. It is available at* www.leasefoundation.org.

Higher returns suggest that Independents operate guided by management practices that include a strong pricing discipline and a focus on those customers that are willing to pay higher financing rates.

market size opportunity for Independents. Based on the key industry verticals that Independents focus on, their financing opportunity is large and in many industries growing, now exceeding $122 billion. (By "vertical," we mean an industry or subindustry focus. For example, it might involve transportation or a niche within the industry in which the Independent can demonstrate its expertise, thereby differentiating itself from competitors.)

In addition, recent growth and performance metrics for Independents show this segment's continued importance and strength:

- NBV growth for Independents has exceeded that of Banks and Captives in each of the last five years, at 10% last year versus 5.3% and 9.9% for Banks and Captives, respectively. Almost 65% of all Independents increased their NBV last year, higher percentages than for competitors.
- While Independents operate with a higher cost of funds, Table 1 shows Independents generate higher yields and returns versus Banks and Captives, in part due to lower compliance costs and capital requirements.

In summary, while share has declined, the market opportunity for Independents remains large. Growth trends are positive. As we will discuss below, higher returns suggest that Independents operate guided by management practices that include a strong pricing discipline and a focus on those customers that are willing to pay higher financing rates either due to their risk profiles, need for structuring flexibility, time requirements, or other factors.

Independents believe they can manage the higher risk they may take on due to their industry knowledge, structuring expertise, and ability to balance risk and reward.

BUILDING AND SUSTAINING INDEPENDENTS' SUCCESS

FIC interviewed a cross section of Independents, both large and small, and startups as well as companies in operation for decades. Three factors play a key role in determining how Independents operate day to day: culture, strong practices in personnel selection and management, and what we term "strategic opportunism."

Culture

Culture often defines how employers interact with employees and how employees interact with each other and with customers. Our Foundation study presents a case example featuring GreatAmerica, a company that its founder created, in part, based on instilling a common culture of openness and respect both internally and toward customers.

Many interviewees at other firms stated that the cultures they were establishing stood in stark contrast to their experience at prior employers. One commented: "I worked for a company that said all the right things, but it was not authentic."

Culture incorporates a number of support elements:

- Accountability and responsibility. Interviewees stressed the importance of personal responsibility and the fact that "There is no place to hide here."
- Constant communication and transparency. One executive said, "If anything, we over-communicate our vision."
- Employee training and internal "muscle-building." Muscle-building involves moving employees from one unit to another to develop them and provide more career options. One manager mentioned this approach was particularly important to attract and retain millennials.
- Adaptability. Over the decades equipment finance companies have had to respond to multiple disruptive events, including accounting rule changes, funding crunches, greater competition from banks and, more recently, the emergence of nonbank digital lenders such as Paypal, Amazon, American Express, and OnDeck, that are willing to make equipment-related loans, typically for small ticket amounts.

The most successful Independents have managed through these changes and more. They possess the culture, skills, and management strength required to proactively identify macro-changes and redirect their company's efforts as necessary. Independents have been "pivoting" (meaning evaluating the competitive landscape and thoughtfully altering direction as required) before the word was in wide use. The ability to pivot, in addition to a culture of innovation, is in the genes of most Independents.

Table 1. Performance Returns (%)

	Industry	Banks	Captives	Independents
Median pretax yield	5.70	4.52	5.84	8.81
Median pretax spread	3.00	2.50	2.90	4.62
Return on average assets	1.70	1.50	2.40	3.00
Return on average equity	16.70	15.70	20.0	21.20

Source: 2018 ELFA Survey of Equipment Finance Activity, illustrations 10c, 18a, and 18d.

Strong Practices in Personnel Selection and Management

Building a strong culture carries over to personnel choices. Independents focus on finding people with the right fit for their company. For example, a Midwestern company has found that non-Midwesterners usually fail at that firm. In that executive's view, there is a distinctiveness to a Midwestern approach that "outsiders" find a difficult fit.

Hiring philosophies differ widely. Some companies pursue millennials, interns, and nerds, while others want highly experienced employees who can contribute from day one. Compensation for sales staff is another area in which Independents try to distinguish themselves. Several mention that they place no caps on sales compensation, contrary to some Banks and Captives.

Strategic Opportunism

As discussed below, the success of Independents relies on their ability to exploit verticals and niches. Most Independents operate with organizational flexibility, minimal internal bureaucracy, and relatively few steps required to make a decision. They can quickly seize business opportunities that arise.

In one instance, the head of a transportation business learned of a niche player for sale. The niche player represented a new business line: one that would expand capabilities and add an experienced team that would immediately contribute to earnings. The company was able to react to this strategic opportunity and acquire that niche company within a matter of weeks.

HOW INDEPENDENTS DIFFERENTIATE THEMSELVES

Independents operate in a world in which Banks can offer lower rates and Captives have a point-of-sale advantage. For one thing, they must provide benefits to their customers that in most instances also involve higher financing costs. Independents differentiate themselves and provide value based on at least one, but more often a combination, of three elements: their knowledge of verticals and niches, the relationships they develop, and their use of technology.

The Power of Niches and Verticals

Typically, Independents target areas that larger players do not emphasize. Whenever possible, Independents avoid head-to-head competition, selecting subsegments that the biggest competitors may view as too small or too complex.

One company FIC interviewed focuses on the agriculture business, largely dominated by major manufacturers and their Captives. However, this company targets areas that are outside the interest of most Captives: "We focus on used farm equipment that most others avoid. We also have a specialized knowledge of some fairly unusual equipment. Big lenders don't want to bother with this." Other companies mentioned they concentrate on areas in which the potential volumes are limited and where "most banks don't find the area attractive."

Independents also develop areas of vertical industry expertise while being aware of potential concentration risk. They approach managing concentration risk in different ways. One Independent focuses on financing IT, healthcare, and materials handling equipment. Another works with 20 verticals to avoid concentration risk.

The Independents' niche emphasis goes beyond vertical or subsegment focus to include deal structures. Independents often focus on transactions that require complex structures, an area banks may avoid except for a top-tier credit: "We want to do a nonbank friendly asset. We will do nonstandard equipment with little liquidation value and some air ball. A bank won't do that."

One company addresses potential risk issues by using an intense due diligence process to price, underwrite, and monitor credits: "We know the equipment, we structure it with a security deposit, and we have corporate guarantees. We make money because we may ask 20 or more questions than the banker."

Moreover, unlike some larger competitors, most Independents operate with more limited NBV expectations. One executive commented, "We don't need 25% market share," meaning his company can pick relatively small subsegments to focus on and not stretch for deals.

The Independents' niche emphasis goes beyond vertical or subsegment focus to include deal structures. Independents often focus on transactions that require complex structures, an area banks may avoid except for a top-tier credit.

Independents are continually evaluating their niches, eliminating some while adding others. One interviewee discussed the structured approach his company uses to evaluate new niche opportunities: "We look at a possible new niche at least once a year. … The business and sales leaders evaluate its size and attractiveness, and risk people also have a view. … You should be doing this as a matter of course; it takes five to six years to build a niche."

Another Independent assesses each industry quarterly, with

One industry veteran summarized his firm's continual review process: "We have been in 74 verticals since we started. Now, we are in 20 significantly." In short, developing a niche focus requires a dynamic review process.

more formal annual reviews. Independents exit a business based on rate pressures and credit performance: "In the past few years we pulled out of two or three vertical markets because the underwriting quality was not that great and there was some compression in rates."

Importantly, exiting a niche does not appear to create internal defensiveness. One industry veteran summarized his firm's continual review process: "We have been in 74 verticals since we started. Now, we are in 20 significantly." In short, developing a niche focus requires a dynamic review process.

Relationships Still Matter

Building strong relationships with customers continues to be critically important to Independents' success. But, today the basis of a relationship rests on the differentiating value that an Independent can provide. The specific value on which Independents base their relationships varies: information, integration, speed of decisioning, structuring ability based on industry expertise, and so on.

One interviewee summarized how his firm uses value to build a sustainable relationship: "Value is worth more than a lower price. If I can process a transaction more efficiently, it will save time. That creates value. If I can provide a more integrated offer … that creates value. If I can develop a program to help the customer sell more … that creates value as well. If our billing is clear and error free and if our dispute resolution is fast, that creates value. This approach has allowed us to build long-term relationships with our vendors."

Technology May Separate the Excellent From the Mediocre

To a significant degree, Independents vary in their focus on and their use of technology. Some firms state they are "all in" on technology; others sit on various stages of the digital path. Virtually all are spending more time and dollars on IT. Even those companies that emphasize the power of their relationships also understand the value technology brings, both to increase efficiency and to build client ties.

Increasingly, companies are using technology both to improve efficiencies and to increase the value they provide. Table 2 summarizes some areas in which companies are applying IT solutions.

While most interviewees view leveraging IT as essential, some continue to doubt the need to focus here. Ironically, one Independent that works with end customers on IT-related financing described itself as being "like the shoemaker's children," saying that state-of-the-art IT was not necessary: "We don't need it. What the customer needs is our innovative funding approaches." Other Independents disagree.

A relationship approach backed up by technology is vital. IT can both create a barrier to new competitors and position a firm for the long term by linking it closely with its customers and making them difficult to dislodge. "Some say automation drives customization. For us automation drives differentiation. We offer a convenience-driven solution."

Companies that drag their feet in making IT investments may be at a disadvantage: "We cannot be on the fence related to IT. We give our technology to our clients and are very proactive in providing them with insights."

Table 2. Technology Application — Examples

Marketing	Origination	Underwriting	Risk management	Customer service and differentiation
▪ Digital marketing ▪ Database analysis of leads ▪ All activities entered into CRM	▪ Paperless applications ▪ Faster decisioning	▪ Credit scoring ▪ Pricing models ▪ Risk analysis	▪ Early warning system ▪ Portfolio management	▪ Portal ▪ Cost-management insights

Source: FIC Advisors.

CONTINUED OPPORTUNITY FOR THE BEST INDEPENDENTS, BUT…

Recent performance shows strong returns and low delinquencies and losses. Despite uncertainty, the general outlook for the economy and business fundamentals remains positive.

Cautious Optimism

Experienced Independents know that good times cannot last indefinitely and are preparing for a downturn: "It's a cycle. These are the heydays. We are looking at how to prepare for a downturn. That involves reviewing our portfolio, looking at internal limits, making sure we have an early warning system, and not being afraid to slow down growth, if quality growth is not there."

Just as some players are evaluating their own growth plans, they express skepticism about fast- growing rivals, particularly those that have generated significant volume in recent years.

Several even view a downturn as positive for their companies: "We do better when credit is rapidly expanding or shrinking. We would like a little more turbulence so that the Banks pull back."

Questioning Rapid Growth

Just as some players are evaluating their own growth plans, they express skepticism about fast-growing rivals, particularly those that have generated significant volume in recent years. One company executive commented: "The behavior today seems like the same as before the 2008 downturn. … Some people think there is a 'new normal,' but I don't buy that. Subprime is subprime."

Several interviewees mentioned they have observed competitors that, in their view, were "stretching for growth."

More Acquisitions?

Does the future also involve another round of consolidation of the Independent space as Banks look to acquire more assets? One potential buyer thought there is little of quality to buy right now, given high pricing expectations: "There are slim pickings on the acquisition front. We're not finding a lot of big Independent leasing companies to buy."

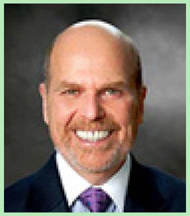
What Could Go Wrong?

Interviewees raised a number of possible problem areas:

- Funding. "Banks could have a bust and reduce funding, but a major fraud is more likely to cause Banks to stop funding Independents."
- Credit quality. "Many companies that have been started up in recent years have been built to sell. Those companies have been focusing on the short term. Some have been growing by giving dollars away. The problems do not show up for several years."
- Business segment risk. "Over the next 10 years, small ticket loans will be commoditized, like the credit card."
- Interest rates. "With rates going up, there is an increasing squeeze on spreads. More risk-taking has been occurring due to the low interest rate spreads. This has pushed risk-taking to new heights. There is so much liquidity that people want to put to work. This will come back to haunt some companies."
- The emergence of Fintechs. Independents are increasingly aware that digitally enabled lenders have the potential to disrupt their segment. For example, recently OnDeck announced its entrance into small ticket leasing. One interviewee mentioned about his firm: "We've been a Fintech for a long time but just didn't call ourselves that." More Independents are also evaluating whether and how to partner with Fintechs.

Management discipline, marketing focus, and a strong and supportive culture typify the most successful Independents. While the next downturn may push out those companies that have compromised credit quality for growth, Independents will continue to adapt to changing circumstances in the future as they have in the past.

Betting against Independents is a mistake.



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Charles Wendel is president of FIC Advisors Inc. in Miami, Florida. He had extensive practical experience as a bank lender, relationship manager, and workout specialist before becoming a management consultant. Prior to founding FIC over 20 years ago, he was a partner at Mercer Consulting and an engagement manager with McKinsey & Co. Mr. Wendel has consulted to money center and regional banks, insurers, and diversified financial services companies, both in the United States and abroad. He is a regular contributor to *BAI Banking Strategies*, the *Monitor*, and other publications and speaks frequently at industry conferences focusing on business banking, digital banking, equipment finance, and Fintech. He has also appeared on CNN, CNBC, and Bloomberg radio. Mr. Wendel earned an MBA in finance and marketing from Columbia University in New York City, in addition to an MA and MPhil in English. He received his undergraduate degree from New York University, also in New York City. Mr. Wendel's last article for this journal, "The Impact of Alternative Finance on the Equipment Finance and Leasing Industry," was published in the Spring 2015 issue (Vol. 33, No. 2).