EQUIPMENT LEASING & FINANCE
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JOURNAL

OF EQUIPMENT LEASE FINANCING

VOLUME 38 • NUMBER 1 • WINTER 2020

The Impact of Digital Lending on Equipment Finance

By Charles Wendel

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Digital changes are impacting all aspects of financial services. Initially, these changes focused on consumers, but this movement now includes commercial and equipment finance lending. Meeting the growing requirements of business customers has become an imperative for many equipment finance companies serving borrowers of various size and sophistication.

Beyond addressing customer expectations, digitalization can play a major role in reducing operating expenses and streamlining internal processes, two other major areas of opportunity.

FIC Advisors recently completed a report for the Equipment Leasing and Finance Foundation that involved our accessing and analyzing extensive research from multiple technology and consulting firms, interviewing 20 industry executives, and conducting one-on-one interviews with end customers. Our report focuses both on describing the current state of the digital revolution and providing insights into areas of particular importance for equipment finance.

While the report discusses multiple challenges and choices facing the industry, 11 key takeaways emerge.

1. "Going digital" differs for each lender.
Going digital does not necessarily mean that all paper will disappear or that no humans will touch an application or internal process. It often involves leveraging automation and technology to the extent possible for internal processes.

However, going digital also requires continued servicing of the analog-

Editor's note: This article is based on the author's Foundation research report titled Going Digital: Current Activities and Future Expectations, *published in December 2019. It is available at* .

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One executive summarized that going digital instead requires a company "to reimagine how we work with customers, vendors, and internally."

oriented customer. One company mentioned that it continues to take applications in nine different ways, including by fax. Even some Fintech lenders combine digitally enabled lending with human interaction by phone or other means.

2. Going digital requires reimagining the current business approach.

Few companies approach digital with a fundamental relook at their business model. One executive summarized that going digital instead requires a company "to reimagine how we work with customers, vendors, and internally." This reimagining is critical to achieve the full benefit of digital.

However, the report discusses how some lenders focus on addressing one-off specific "pain points" rather than reviewing their business more holistically.

3. Equipment finance companies are currently in different stages of understanding and addressing digitalization.

Based on our research and interviews, in general small-ticket lenders, both direct and vendor oriented, have placed the greatest focus on providing an overall digital environment to their end customers. In addition, a digital platform allows these firms to originate and process small loans with the level of efficiency required for profitability.

Our report features a case study with AP Equipment Financing (AP), a small-ticket lender that outlines the degree to which it has applied digital practices across its business system. Companies like AP view themselves as "all in" on digital technology.

At the other extreme of size, large corporations have also been leaders in promoting digital linkages with their lenders. Some of these borrowers require portals of equipment finance lenders to integrate with their systems.

Interviews with middle-market lenders showed the greatest diversity in their digital focus. Some managers emphasized the importance of digital technology for customers, while several saw little to no need for current digital investments. This level of diversity may exist because some middle-market end customers have yet to update their internal processes.

Those focusing on building digital capabilities for the middle market include Key Bank (Key), another case study. Given the specific interests of its customer base, Key decided that it was important to provide a digital servicing environment for its customers, prior to offering a digital origination channel.

4. Industry research indicates that customer demand for a digital experience will increase.

Equipment finance companies and their customers may be in different

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Digital expectations are growing, and traditional lenders need to meet those needs or face losing share, whether to Fintech lenders or to traditional lenders that have moved forward with digital technology.

stages of digital development, but the trends moving toward adoption of digital banking are strong and increasing. Today, the people managing commercial borrowers use digital banking in their personal lives and expect a similar business experience.

One survey cited in the report states that 85% of commercial customers now use digital banking for their personal banking needs. The same survey found that 72% of corporate customers view digital capabilities as a key factor in their selection of a financial services provider. Further, a Federal Reserve survey shows a three-year increase from 20% to 24% in online loan applications.

Digital expectations are growing, and traditional lenders need to meet those needs or face losing share, whether to Fintech lenders like Square and Fundera or to traditional lenders that have moved forward with digital technology.

5. Digitalization is a tool, not a solution in itself.

Going digital can provide critical value. A digital offer can help to grow revenues by attracting new customer groups and retaining current ones by enhancing their experience. It can also improve operating expense ratios, eliminating redundancies and eliminating staff.

The value that digitalization provides across a company's business system will likely increase over time as digital solutions mature. While it provides a powerful and essential tool for success, however, digitalization is not sufficient unless management aligns its corporate strategy, that is, its business line emphasis and customer segmentation focus needs with its technology investment priorities.

Several interviewees mentioned what they viewed as the hype around all things digital and expressed concern that some lenders might grow frustrated with the time and investment required to create digital change.

6. Digitalization involves an ongoing process that needs the close active support of internal management.

The report includes case studies of AP Equipment Financing, Key Bank Equipment Finance, and TIAA Commercial Finance (formerly EverBank) discussing their digital focus.

While their starting points, time frames, and goals may differ, all agree that digital changes are ongoing. In other words, this is not a project that ends. Instead, it continues to evolve as technology and customer needs evolve. The TIAA case highlights the journey mapping approach they continue to follow, a multiyear process that requires detailed planning, multiyear project budgeting, and the long-term support of senior management.

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Equipment finance companies will often need to work with third-party vendors to provide a digital offer to customers and to achieve cost reduction.

In contrast to TIAA's management, interviews with several other lenders mentioned their management changing gears to put resources behind other efforts, undercutting digital initiatives already underway.

7. Going digital may demand that lenders work with multiple vendors.
Equipment finance companies will often need to work with third-party vendors to provide a digital offer to customers and to achieve cost reduction. Most lenders lack the expertise, time, and dollars to develop solutions internally.

Many lenders use out-of-the box operating platforms and link them to other applications for sales and workflow management, pricing, tax, insurance, and other needs. This approach necessitates an effective internal effort aimed at vendor selection and management.

8. Technology assessment and adoption processes need to be streamlined and shortened.
For many lenders — particularly those that are bank or captive owned — vetting, approving, and implementing digital solutions can take years. At the same time, many of the most innovative vendors may be relatively new companies without the long track records that provide buyers with a level of comfort. Even once approved, adoption of established technologies such as e-signature and OCR (optical character recognition software) can be slow.

Lenders should consider instituting a selection and due diligence process that begins with specific yearly goals, including the digitalization of the back office and processes impacting the customer experience such as applications and service. They also need to establish time frames for each step and create regular reviews to ensure projects remain on track and management remains supportive.

Ideally, this process will have a leader with a strong internal reputation and the clout to cut through internal silos to reach timely decisions.

9. Lenders need to create and support a digital culture.
Establishing a digital culture requires a lender operating with a mind-set that is open to challenging past practices, to consider the customer experience as paramount, and to allow for some experimentation without recrimination if the experiments fail to generate the hoped for results. Figure 1 summarizes the key elements required to build a digital culture.

The report discusses each of these 10 areas, and several of these areas have been touched on elsewhere in this article. Three areas merit particular focus here: the use, discernment, and innovation.

The use of data to drive analytically based decisions. A consistent data-management process and data integrity are both

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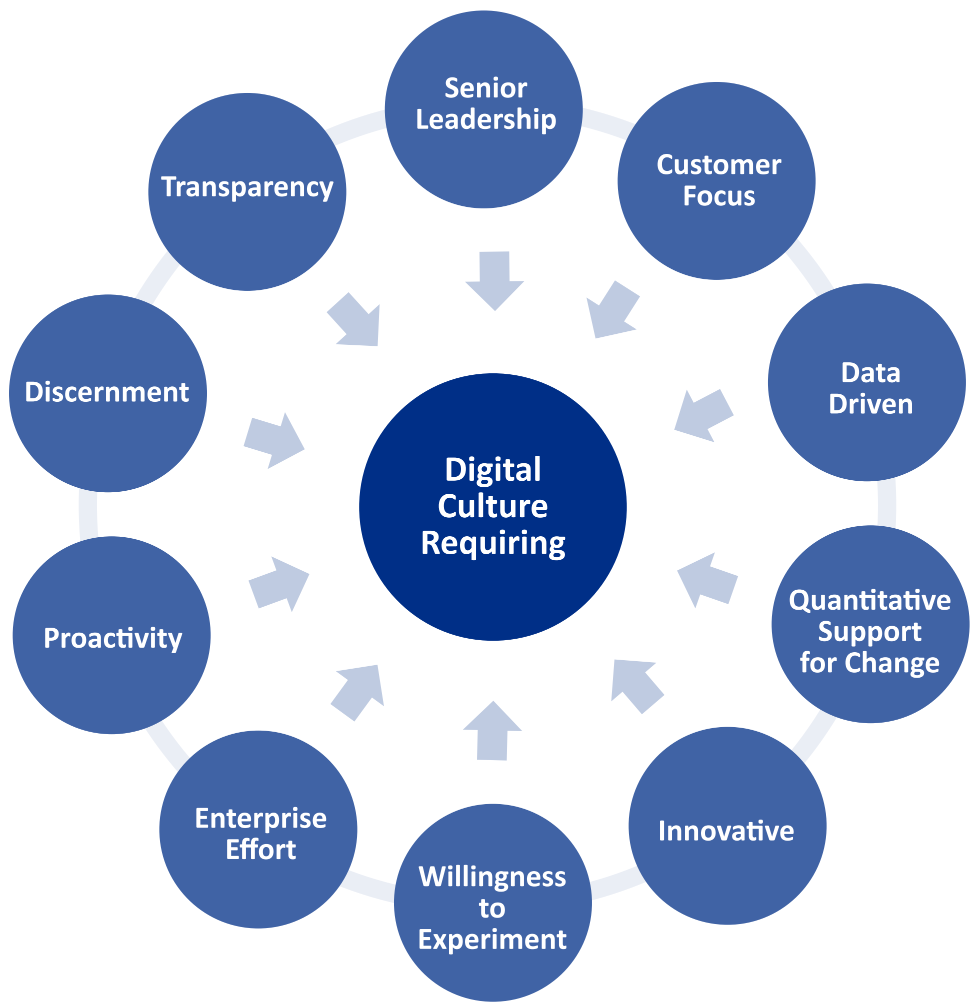
Data integrity is a critical aspect of data management and involves ensuring the accuracy and quality of data submitted. Both accuracy and quality are necessary for digital technology to succeed.

critical for building the foundation for quality decisionmaking. A data management process involves establishing a uniform approach to acquire, validate, store, and access business-specific information. Data integrity is a critical aspect of data management and involves ensuring the accuracy and quality of data submitted. Both accuracy and quality are necessary for digital technology to succeed.

The report discusses the long-term value provided by artificial intelligence. However, our interviews revealed that multiple companies believed their data was not yet organized and accessible enough to allow for applying AI for insights or decisionmaking.

Without improved data quality and completeness, these companies cannot benefit from AI-based insights. Data integrity forms the basis required to provide qualitative support to recommend changes or new approaches.

Figure 1. Change Elements for Building a Digital Culture



Source: FIC Advisors Inc.

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To avoid going down the wrong path, lenders need to develop an internal team of digital experts who understand both the emerging technology and the priority needs within their company and its customer base.

Discernment. FIC's research uncovered dozens of digital options for lenders to pursue. In some cases we found that ideas that were suggested a year or two ago, such as blockchain, were now viewed with increased skepticism by some technology experts.

Digital technology options will likely continue to proliferate as both established and startup vendors attempt to exploit what they view as market opportunities. To avoid going down the wrong path, lenders need to develop an internal team of digital experts who understand both the emerging technology and the priority needs within their company and its customer base.

Innovation. Comments from bank and captive-owned lenders mentioned their frequent frustration in achieving internal consensus around initiatives they considered innovative. Complex approval processes, the number of functional groups required to approve an idea, and the prevalence of organizational silos all combine to hinder innovation.

One executive described his company as an "innovation killing machine." In general, an independent player does not face this particular challenge, although most lack the people and economic resources potentially available to banks and captives.

10. Lenders should begin with a self-diagnosis.

As it considers its focus on digitalization, each lender begins from a different starting point, has unique end goals, and operates with a distinct time frame for achieving those goals. Figure 2 provides a matrix that companies can use to consider the quality of their digital offering versus their view of the current customer's desire for a digital offer.

This chart reflects the views of 15 equipment finance executives evaluating their company and its digital needs. To explain, the lone company in the lower left-hand corner has an admittedly weak current digitalization offering and believes that its current customers have a low need for a digital customer-facing solution.

Those occupying the upper right-hand corner of the diagnostic provide a stronger offering, and at least some appear to be meeting most of their customers' digital requirements.

By its nature this diagnostic is subjective. For it to be more accurate and provide greater value, management should consider bringing together an internal group of leaders to gain agreement on the quality and gaps in the company's digital offering today as well as an assessment of current and emerging customer needs.

Our client experience indicates that different groups within a

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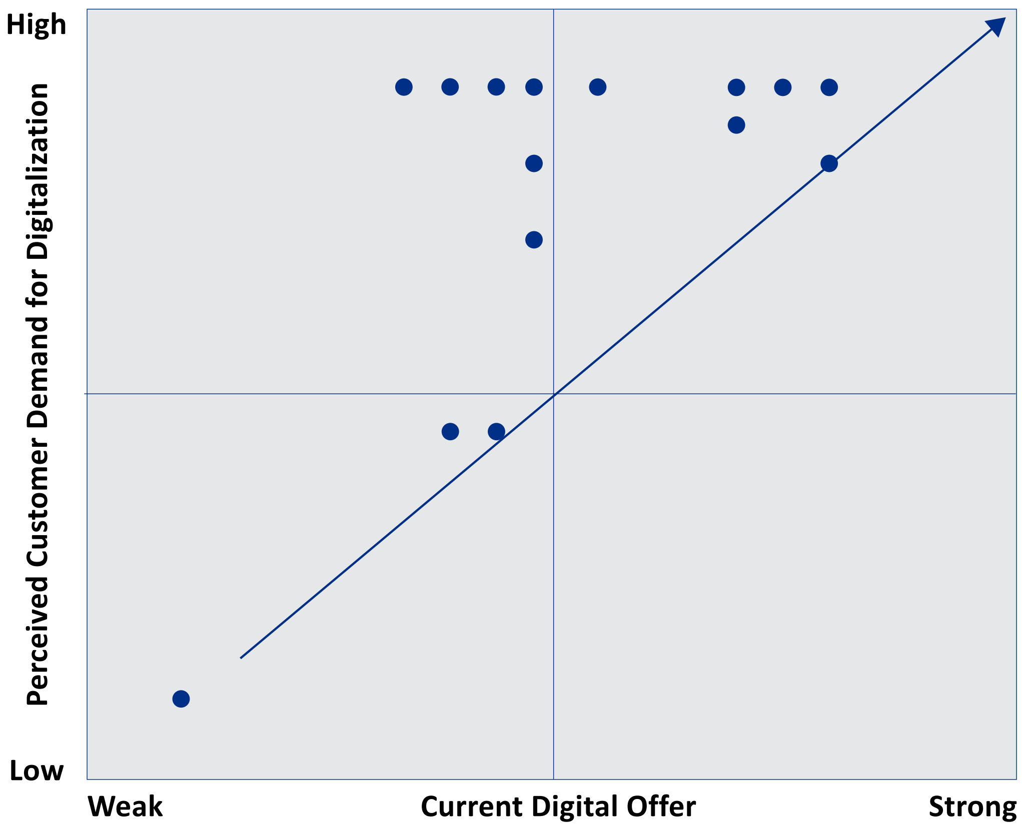
Starting with a frank diagnostic assessment provides a needed foundation for decisionmaking and, depending on the company's starting point, its options and priorities will differ.

Figure 2. The Digital Matrix Diagnostic



Source: FIC analysis.

lender's organization will offer distinctly different perspectives and may result in clearer priorities for a company. Starting with a frank diagnostic assessment provides a needed foundation for decisionmaking and, depending on the company's starting point, its options and priorities will differ.

11. The growing role of artificial intelligence.

While we mentioned the number of digital initiatives vying for a lender's attention above, it is clear that AI will increase in importance. AI represents a family of capabilities, and many of them remain in early stages of development. As equipment finance companies improve their foundation platforms and AI matures, its value will be significant.

AI can allow companies to target prospects more effectively and generate improved productivity from equipment finance lenders by improved targeting of prospects and highlighting cross-sell opportunities. When used in conjunction with data analytics, it can also improve risk-based pricing and early warning systems to detect deteriorating credits.

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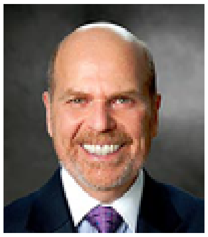
CONCLUSION

No matter the status of their current technology focus, all equipment finance lenders should assume that customers will increasingly look for a digital-savvy lender to work with going forward. In some cases customers already do so and for others the time frame may still be years away.

Nevertheless, the movement of customers to a digital environment seems certain. Even without current customer demand, however, lenders should be working to exploit the opportunity that digitalization provides to improve internal costs and streamline processes.



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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, "Independents: Niche Focus for Continued Success," was published in the Winter 2019 issue (Vol. 37, No. 1).

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