Learning From Independent Lessors
by Charles Wendel

FIC recently completed an analysis of Independent equipment finance and leasing companies for the Equipment Leasing and Finance Foundation (ELFF). The ELFF is the leading association for Banks, Independents, and Captives in this industry. As we were assessing Independents, we realized they might offer some important lessons for banks managing through an increasingly uncertain time.

First of all, a definition. An Independent is just that, owned by neither a Bank nor a Captive. Some Independents are family owned while others are private equity financed; relatively few are public companies. Decades ago, they dominated the leasing finance industry. In part related to the last recession, their market share number is much lower and likely to remain lower as deep-pocketed Banks will remain active in this business segment. In fact one key factor in the reduction in Independents' market share is the extent of their acquisition by Banks and the shift of some Independents to Bank status.

While they no longer hold the dominant share position in the equipment finance business, they remain leaders in how their strategic focus, culture, compensation, use of technology and discipline generate high ROAs and ROEs. Many community and regional Banks have also lost share and are fighting to remain relevant to a consumer and commercial customer base that has increased in sophistication. That's why some Banks should consider the approach Independents are following to build a sustainable market presence and consider how they can adapt the Independents' approach to their own situations.

Strategic focus on niches and verticals. Independents learned long ago they needed to pick their spots in the types of companies they serve. Banks operate with a significant funding advantage versus Independents while Captives lever their POS opportunity. Independents know they need to focus where these bigger competitors do not play and offer capabilities others cannot provide.

For example, big Captives lessors like John Deere dominate the agriculture business. But, we interviewed one Independent that has long specialized in the ag business. Unlike the big players, this company focuses on used equipment and more exotic equipment that other lenders avoid. Not surprisingly, borrowers will pay higher rates and fees to close these transactions. This company has developed a strong base of information and a set of residual buyers that give it the confidence to play where others fear to tread. And, their long history points to their success.

Many Independents emphasize verticals, that is, industries or sub-segments that allow them to provide value based on their equipment knowledge and structuring expertise. Like Banks, they want to establish relationships, but unlike banks they cannot rely on low rates or a long-term client base to do so. They have to prove their higher-cost value, and many have done so for decades. Some focus on their industry knowledge, others on specialized structuring ability, and some in being comfortable lending further along the risk curve (and getting paid back!). They also make sure to avoid concentration risk, focusing on multiple verticals rather than betting too heavily on one or two.

Culture. In the 20+ interviews we conducted with senior leaders at Independents, most mentioned the importance of a strong and transparent culture. They stressed the need for open communication, their lack of silos, and the ability to pivot and change direction when necessary (without executing anyone for past decisions). Several execs mentioned that when they worked at a Bank, management said the right things but that the reality differed. Collegiality and the constant exchange of information seems the norm at Independents.

Technology. Some Independents that focus on small ticket deals state that they are "all in" on technology and that they lever IT to embed themselves with their clients. Other Independents concentrating on larger loans stress the expertise and relationships that their senior staff provides. Even then, however, management emphasizes the role that data analytics plays in showing value to their clients and proactively helping them to manage their businesses more efficiently. Using technology to differentiate themselves with clients is a key part of relationship building.

Compensation. While the staff of many Independents comes from Banks, Independents and Banks have a symbiotic relationship. Banks often fund Independents, buy deals from them and/or refer transactions to them that they will not underwrite themselves. That said, many Independent execs speak of their frustration during their time at a bank:

- Internal deal approval hurdles increased, slowing down the approval process and often resulting in the banker losing a deal…to an Independent
- Individual compensation did not align with lending performance
- Caps in compensation existed, disincenting the bank sales person and oftentimes resulting in their exit from the bank

Independents pay sales staff, in particular, for performance and exit poor performers. Pay for performance is the standard. That's not always the case at Banks.

Discipline. The best Independents know their strengths and weaknesses and act accordingly, avoiding areas in which success is unlikely. They also tend to be frank in their self-assessment.

Of course, Independent lessors do not carry the heavy regulatory burden of Banks, and they are not pushed by regulators to serve unattractive segments. Conversely, Independents have to overcome much funding costs. Both groups have competitive challenges. In our view, based on our analysis of this group, Independents can provide some Banks with valuable insights on possible paths to sustainable success.