



WHITE PAPER

WHAT ASSET FINANCE DID NEXT

Trends, Challenges and Opportunities
in a New Age of Leasing

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ASSET FINANCE NEEDS A MODERN MINDSET

The world is changing and so are the ways that consumers and businesses pay for goods and services. When it comes to buying vehicles and equipment, asset finance has long offered a more flexible alternative to upfront, outright purchases. But increasingly, traditional leasing models struggle to accommodate the latest trends.

Great socio-economic shifts are underway and accelerating all the time. Do you have the mindset – and the operations – you need to keep up?

What's new for lessors?

Three major developments in particular are disrupting the status quo for the auto and equipment finance industry and driving finance providers toward new ways of funding, thinking and working.

While these trends affect many, if not all, industries to some extent, they have especially big implications for lessors and original equipment manufacturers (OEMs). And as both challenges and opportunities, one trend very much leads into another.

1. ESG

Environmental, social and corporate governance (ESG) is already a well-known and well-used term in the world of business – and for many good reasons. As climate change continues to take its toll on the planet and scrutiny increases on corporate values and company structures, there's more pressure than ever for firms to demonstrate sustainable, fair-minded and transparent practices.

For the asset finance and leasing industry, the ESG challenge is effectively doubled. Not only do finance providers need to fund more sustainable or reusable assets with as long a life cycle as possible, but their customers also have their own ESG requirements and objectives.

On two counts, then, there's no escaping ESG. Plus, in many countries, government initiatives are now handing out tax penalties for assets that don't meet strict criteria.

Striking a balance in asset finance

With so much at stake for the environment, societies and economies, the asset finance industry as a whole is clearly on board with ESG principles and firms are actively looking for ways to burnish their credentials. However, the journey toward sustainability is only just beginning for most organizations as they acclimatize to the idea, determine their objectives and work out how to achieve them.

Clearly, things are a little more straightforward for auto finance firms, as legislation drives them toward electric vehicles and, with coming bans around the world on petrol and diesel engines, gives them hard and fast milestones to reach.

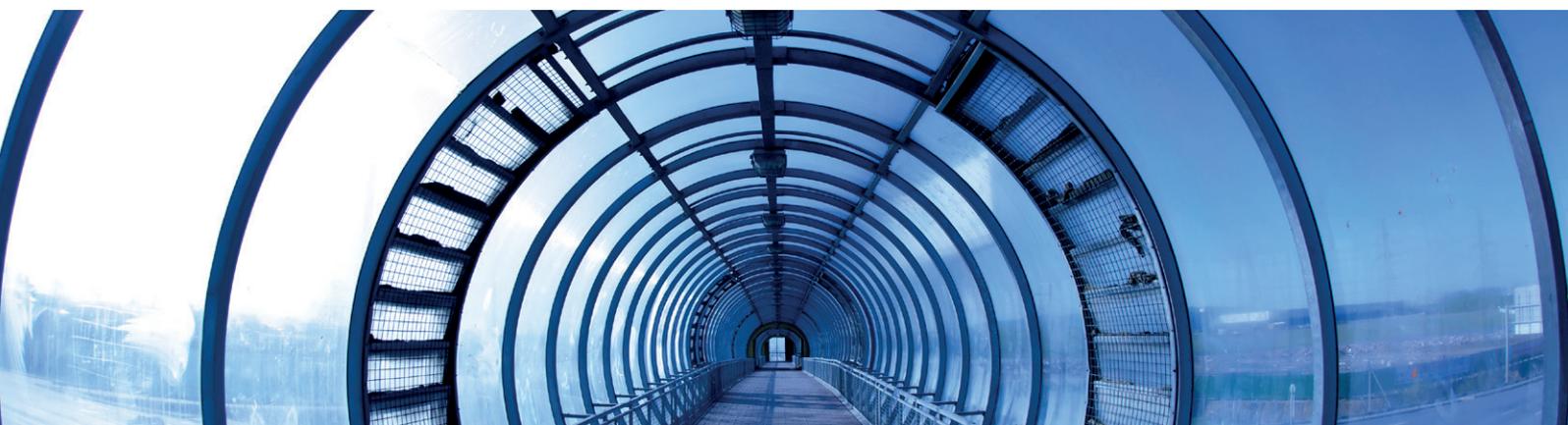
For equipment lessors, the targets are more nebulous. The key will be for firms to balance their own ESG requirements with those of not only their customers but also of their OEM suppliers and partners, who must also think hard about how to reduce the carbon footprint of their products and improve their social responsibility.

Arguably, though, none of these three parties may be as eager to focus on the corporate governance aspect of asset finance contracts or encourage too much scrutiny of pricing processes. All of which segues neatly into the second trend on the list...

2. Servitization

Servitization is another term for what consumers call subscription and businesses – including asset finance firms and customers – call pay-per-use. Rather than purchasing and taking full ownership, servitization lets you pay to use (or rent) items as and when you need them. The less or more you use, the less or more you pay.

How you measure usage varies from asset to asset. It could be by kilometer, per minute, per ton, per item produced and so on. Either way, it makes for a responsible, ESG-friendly form of financing and using equipment – one, in fact, that Xerox has been offering for years, by allowing customers to pay per sheet of paper when they lease photocopiers.



So, there's nothing new about pay-per-use in asset finance; it's just that most asset classes have yet to catch up with the Xerox model.

Although leasing was always ostensibly about usage over ownership – and was actually invented specifically for business users, over 50 years ago – finance providers have continued to base their pricing of assets on the cost of outright ownership. Traditionally, they've simply divided the full retail value of the asset into installments – and have chosen, as the saying goes, to “fund and forget.”

The move from ownership to utilization makes the math more complex and so introduces enormous challenges for asset finance pricing processes and their governance. When no one customer pays for an asset in its entirety, it's much harder to relate payments to the value of the equipment.

What's more, it then falls completely to the financier to find multiple customers and ensure multiple life cycles and contracts for the assets they own. Rather than focusing solely on credit risk, lessors must now assess and evaluate utilization risk, too.

The challenge, then, will be to find enough customers to use an asset over its lifetime and generate enough revenue to pay for its total cost. You can no longer fund and forget; to maximize value, you need to keep ensuring maximum usage. Ultimately, that means a massive change of mindset for the asset finance industry.

As a classic example of funding and forgetting, the personal contract purchase (PCP) loans that have long underpinned auto finance show the distance most firms need to travel to support a pay-per-use economy. With PCP, a single customer ends up paying 100% of the cost of a car but could drive it as little as 6% of the time on average. In simplistic terms, offering the same car on a pay-per-use basis theoretically leaves 94% of its life cycle to be made available to another 15 customers.

Moving from finance to service aggregation

The other problem with generating pay-per-use revenue is that finance margins can only go so far. There's a limit to how much customers – especially corporate customers – will pay for asset finance, and so the only way to grow profits through servitization is to offer additional services to support the asset and optimize usage.

In the aviation sector, this kind of service aggregation has long been a key part of asset finance arrangements. Rather than own their planes, most airlines lease them and pay for a large package of services on the side, with OEMs typically taking care of maintenance on an ongoing basis and keeping aircraft safe.

In a pay-per-use world, this model will need to be extended to the whole auto and equipment finance industry. In auto finance, for example, the financier could become the aggregator of a full range of services that keeps cars on the road, including taking care of servicing and repairs, annual taxation, insurance, tire changes, wear and tear, etc. As the owner of thousands of assets, firms can source and provide these services more efficiently and cost-effectively than individual users, while still maintaining a margin.

3. Connectivity

If an attractive bundle of services is one way to reduce utilization risk, then another is gathering data on utilization. And in today's increasingly connected world, where all manner of vehicles, equipment, devices and appliances can link up and share data with the internet of things, utilization data is not in short supply.

The question is: who gets that data?

While GDPR regulation limits access to data on privately leased vehicles, there are far fewer restrictions on the monitoring and analysis of commercially leased equipment. As asset owners, finance providers are actually entitled to certain data, although historically OEMs have often kept it for themselves.

Mining data for intelligence

The rise of servitization models now makes it more critical for asset owners to take possession of utilization data.

If financiers can see where, when or how much equipment is being used, or whether issues arise from that usage, they are in a stronger position to optimize pricing. That could mean building in margins to account for services or allowing for replacements when assets are out of operation.

Data is the new gold – and data on usage can spell the difference between profit and loss on a deal. That's why so many asset finance firms are now investing in data scientists, who can extract new meaning from all this information with artificial intelligence and machine learning.

As firms switch their emphasis from reducing credit risk to managing utilization risk, growing volumes of data can incentivize and compensate for their efforts.

Next steps – how asset finance technology must facilitate change

In the changing world of asset finance, expectations and requirements of systems and technology are changing too. And the uncomfortable truth is that very few technology providers can yet service the shift to an ESG-ready, servitization-heavy and hyper-connected environment.

Just as asset finance firms have traditionally taken a “fund and forget” approach, so their technology has been developed to manage one customer using one asset for a set duration.

That has to change, and fast. As pay-per-use becomes more prevalent, more asset finance providers will need a single, holistic view of each of their customers: the different product and contracts they hold and the revenue they provide across multiple assets. Independent of that customer view, they will also need a detailed view of each asset – the multiple customers that have paid for its use and, again, the revenue it provides across its life cycle.

Then there’s the supplier view to consider. In their growing role as service aggregators, financiers will need to pay multiple suppliers of services. With customers making individual contributions toward those services, this revenue needs to be aggregated and then redistributed to the right supplier at the right point in time.

Finally, as both asset-owner and funding-provider, you need your own view of your whole business. This should essentially show whether you’re generating enough revenue to cover your costs from all your customers, contracts and assets.

In most traditional asset finance systems, one or two of these views may be possible but rarely all. For example, a good customer relationship management system will allow you to easily manage, track and analyze your customer interactions, but it won’t be able to tell you about your revenue or help you pay for services.

Flexible modular systems are the future

Getting a single, one-size-fits-all asset finance solution to meet every modern requirement is a tall order, but may also not be strictly necessary. Today, a modular system built on a common code and architecture can bring together compatible best-of-breed components that support different objectives in an optimal way.

As well as modularity, the ideal system offers flexibility in two forms. First, it lets you easily adapt the underlying software applications and write your own code for whatever new functionality you need. Second, through APIs, it integrates seamlessly with other third-party technologies and allows you to benefit rapidly from the latest innovations along the entire supplier/user/funder value-chain.

When the next trend is only ever around the corner, you need a whole ecosystem of modern technology to keep meeting its demands head-on. And with new methods of asset finance now requiring a radical change of mindset, you can’t let inflexible systems hold you back.

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