

# ABC, 123, First/Second/Third

*Product commoditization, company diversification, and an imbalance of supply/demand factors are driving business realities.*

**By Michael J. Fleming**

**E**ACH SPRING I TAKE SOME TIME TO REFLECT ON WHAT I AM seeing and hearing as executives and managers from ELA member companies—thought leaders and the experts who consult and assist them—participate and interact in a wide range of meetings and conferences. From the Industry Future Council meeting in January through the Vendor-Captive and Large Ticket Conferences in April, more than a thousand lessors consider and discuss industry issues and figure out how to take advantage of opportunities, overcome challenges and manage risks.

Throughout these events each of us tries to create frameworks or organize our thoughts to understand what is going on in our environments and what our next steps should be. A speaker might give us the *3 Keys to Success*—123. Others state the *Things to Watch*—ABC. Still other interactive groups come to make their report on strategic actions to take: *First, Second, Third* or their four conclusions about...you get the idea. Some even create a two dimensions matrix.



Adrian Slywotsky asks, "What is your profit model?"

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use of home equity, are just about exhausted. Consumer demand is 70 percent of the economy and so it must be watched.

A constant in all meetings, discussions and presentations is a recognition that business cycles exist and things do go up and down. However, underlying the normal business cycle ebb and flow is the recognition that cycles don't just repeat. There are new winners and losers on each cycle dictated by changing economic structures and new opportunities. Ah, there's the rub—recognizing the structural changes and the opportunities rather than believing that things will return *as they were*. The business cycle is not the big issue for the economy. It is the changing structure of the economy and what we make of it.

According to Reich, in addition to watching the three storm clouds, there are the three vectors that will affect the structure of the economy:

**1. Globalization**—It's not about trade and competitiveness but about investments, integration and value added chains. Globalization can be "our friend" if we use it to add *our* value and access new

### Imbalances

The latter occurred, for example, when former Labor Secretary Robert Reich took Large Ticket Conference attendees through an exciting presentation that focused on the "storm clouds" on the economic horizon. Reich and other economic speakers this winter and spring detailed how the U.S economy is in the fifth year of a modestly weak but consistent recovery. A good sign is that production is up to 82 percent of capacity and productivity continues to grow. But the economic clouds are generally related to supply/demand imbalances:

**1. Growing imbalances.** These include primarily the trade and fiscal imbalances with resulting weakness of the dollar and rising interest rates. However, as discussed later, there is strong liquidity—"super liquidity"—which may reflect a capital imbalance of too much money for good investment as capital struggles to go where good returns exist. Returns may be too low;

companies are getting capital that should not be getting capital, and so on.

- 2. Oil prices.** Rising oil prices to end-users add costs and potentially depress economic activity. Capacity is simply not keeping up with demand. There will be great opportunities in investments related to increasing supply such as exploration, processing/refining, distribution and alternative energies.
- 3. Consumer demand.** Consumers have used various (some would say every) devices to leverage up their ability to buy. Personal spending increased 0.6 percent in March, ahead of the Bloomberg estimate of a 0.4 percent rise, and personal income gained 0.8 percent, topping the estimate of a 0.4 percent rise. Reports indicate that the current expansion continues to bolster consumer spending despite higher interest rates and a moderation in housing. But these "coping mechanisms," particularly the

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markets. Globalization is about adding the highest value, not about the lowest cost of labor. People and companies suffering from globalization are doing so because they no longer have a value to add in a free market.

**2. Technological change**—is scale giving way to customization. That customization (tailoring, specializing, changing *who is doing what*) is largely enabled by technology. Technology has changed marketplace power. The customer, not production or product, is now at the center of power.

**3. Demographics**—Aging, retirement and earnings and savings projections for Americans. Three forces, three clouds, three vectors—what is going on here? Even Letterman keeps coming up with a new *Top Ten List* and Cramer shouts out “*The Five Hot Opportunities Now.*”

## Supply & Demand

In an attempt to grasp a theme from all of this interaction and planning, I am struck by the fact that basic laws of supply and demand

are at work for nearly all companies. Supply and demand factors are constantly shifting and companies attempt to adjust to fill the imperfections. These are called the challenges and opportunities. What are the comments most heard today?

- Too much money chasing too few deals with resulting margin compression.
- A shortage of experienced people for employment needs.
- Too much liquidity enabling financing alternatives for customers and too many lessors.
- Insufficient risk premium built into lease pricing.
- Risk aversion and “me to-ism” creating product commoditization.
- Company differentiation and branding as a competitive strategy.
- Rules are changing what I can do and how I can do it.

Seven major issues! Some relate to supply-demand imbalance. Some relate to strategy. Some relate to compliance. However, how companies are addressing these and other issues is the important thing. It is clear that we have an industry that is becoming increasingly fragmented—differentiated by at least four

dimensions—company type, market, products and strategy.

We hear about the commoditization of the industry. I don't see it. I do see the maturation and commoditization of the leasing *product*. But more and more leaders are staking their companies' position on a business model and strategy, rather than simply on a product. A shift from a product-centric to a customer-centric marketing system is quite evident and will continue. Just ask most companies the following:

- First, who is assumed to have the greatest power in the company's *marketing strategy*: the equipment finance company, the distribution/channel partners or the end used customer?
- Second, in which direction is the power going—who is gaining and who is losing?
- Third, what are the consequences for each of the three as the power imbalance/shifts occur?

It's no accident today that most industry executives talk about win-win and power sharing with customers and channel partners. They did not talk like that when they held the balance of power. This is a good indicator of which direction the power is going.

The point is that leading an equipment financing company and understanding all that is happening in a given market or the total economy is difficult but essential to maintaining power in a marketing strategy. How the above and other issues are addressed calls for very thoughtful and strong leadership.

For example, most of the innovation going on in leading companies has to do with changes in distribution systems and interactions and inte-

gration with customers and channel partners. The product, the lease or other financing product, is the result (solution to customer need) not the driver of the relationship.

In general, marketing strategies have been transitioning for several decades. The transition is from a 1) traditional Product/Production marketing strategy (emphasis on the power of the product and production; “build it and they will come”) to a 2) Distribution Channel marketing system (emphasis on intermediation and logistics and the power of intermediaries—*customer knowledge management*). The trend is going towards 3) Customer Centric marketing strategy (emphasis on the customers’ unique

wants, needs and behavior—*have it your way*).

While more and more of the economy is moving to customer power, and the strategies that reflect customer centric models, most equipment leasing companies remain in the *distribution dominate* strategy. Take banks, for instance. Most bank leasing companies follow a strategy based on serving the parent bank’s footprint. The footprint and the relationship managers who manage the relations with the customer dominate. Share of customer wallet is the overriding strategy. This is neither good nor bad strategy, it’s just the way it is and appears to be efficient and meet everybody’s needs. But it is limiting. Similarly, captives

are very distribution channel oriented (ie. focused on dealers and venders).

Now, people in the banks and captive organizations will tell you that they have defined the channel partner as their customer. Well and good and as it should be, but end users of equipment have the ultimate power in an increasingly efficient and transparent marketplace, and integrating them into your strategy is very important to your power.

Independent companies that are doing direct origination with either channel partners or end users defined as their customer are further along in marketing strategies that are truly end-user customer-centric.

Some companies are so transaction-



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# Some companies are transactional and remain in a product-centric world in which having structuring knowledge, tax base and capital dominates their strategy. But time is running out on that strategy.

al that they remain in a product-centric world in which having structuring knowledge, tax base and capital dominates their strategy. But time is running out on that very traditional strategy. The economics of the product are not as attractive as they once were and there are alternatives in a world of super liquidity.

Compare the lists of *Hopes* and *Fear* described in the *2006 Industry Future Council Report*. (The IFC Report is available on the Equipment Leasing & Finance Foundation website, [www.leasefoundation.org](http://www.leasefoundation.org).) The *Fears* actually represent a very status quo condition and the inability to transition out. The *Hopes* reflect a realization that there is something better that can and must be attained. Then compare the *Hopes* with the *Visions*.

Virtually every one of these *Visions* is customer centric. Integration, transparency, intimacy, simplicity, specialization, customization and convenience are the vocabulary of a customer centric, technology enabled marketing strategy and business model.

Select any of the structural economic changes occurring, such as globalization. More and more sales assisted

financing companies are coming to grips with the fact that they must find a way to follow their customer abroad or potentially lose the customer. Such companies used to be put off by questions of scale or familiarity with a foreign market. But sophisticated segmentation and targeting strategies coupled with new ways of using other partners who can supplement a company's scale or experience shortcoming make it possible to be part of the booming global marketplace.

## The Big Four

From my perspective, there are four things that companies must pay serious attention to this year and going forward. These are not new but they stand out.

### 1. What Business am I in?

Company Positioning. As important as it is to ask, "Why do business with me?" the first question to answer is, "What business am I in?" In a crowded marketplace, what does your answer have to include?

■ What differentiates me that can create a positive image, brand, customization/customer selection, value for my customer, loyalty and

integration?

- What about my model reflects major changes in the economy and my markets in the past three years?
- How can I make a market rather than just take the market?
- In the marketplace, am I driven by a desire to manage risk or avoid risk, to use risk as my friend or fear it?
- What is truly new and unique about me that brings value to my customer?
- How am I part of the global economy?
- Do I have a marketing strategy and organization strategy that align with my answer to, "What Business am I in?"

At the Executive Roundtable, guest consultant Adrian Slywotsky worked with the seventy attending executives as they worked on these and other questions. Slywotsky told the group that business model life cycles are typically five to seven years, but they are getting shorter. He took them through an exercise in which people worked through three questions to understand this business model life cycle change:

### ■ **What characterized the equipment finance business in 2001?**

Tighter liquidity, greater residual play, portfolio quality slipping, more companies, customers looking for more structured product and higher percentage of leasing product than at present. Banks dominated, with captives next followed by independents. Captive, bank and independent executives had slightly different views, but the general picture emerged.

■ **What characterizes the equipment finance business today?** Super liquidity, tight margins and destructive pricing cycle, many competing

## Figure 1. Five Steps in Business Model Development

Today	Future
1. How do I select my customers?	
2. What is my unique value proposition?	
3. What is my profit model?	
4. How do I protect my space?	
5. What do I do myself and what do I outsource?	

alternatives, greater attention to brand and reputation building, service and convenience stressed, high portfolio quality, loss of identity as a “leasing” business, high levels of syndication, consolidation, more loan-like product, little structured product and limited residual based business. The financing is becoming less important than other value adds for the customer. The customer has more power and expectation. Relationship marketing is stronger. Captives and independents are showing the best growth.

■ **What will characterize the business in 2011?** More diverse companies (emphasis on being different), less liquidity than today, more companies acting globally, more attention to staff training, recruitment and learning from the outside, continued consolidation, bundled services, greater integration with channel partners and end user customers, speed and reliability, risk pricing curve less flat and more rational, relations with channel partners and end user customers tied to their success measures, industry/sector specialization offering a variety of products, company brand/relationships very high, efficiencies required and residual based segment strong and profitable. Captives and

## Figure 2.

### RANGE OF PROFIT MODELS

Compete on Price	O	O	O	O	O	O	Compete on Value
(input pricing)							(output pricing)

## Figure 3.

PRODUCT	CUSTOMER	POWER RATION SUPPLIER/CUSTOMER
Unique	Highly Fragmented	90/10
Strongly Differentiated	Fragmented	70/30
Differentiated	Moderately Concentrated	50/50
Weakly Differentiated	Concentrated	30/70
Pure Commodity	Highly Concentrated	10/90

independents show highest growth.

Now think strategically and ask: “What would our company have done differently if five years ago we had known what we know now? What should our company have looked at or thought about then?” See Figure 1 for the suggested steps to developing the business model.

How long will the above model last?

I will say here and repeat often in this article that the biggest risk for equipment leasing and finance companies is not the economic cycles, even though they have to be dealt with.

It is your business model cycle. You will know when the economic cycles occur, others ride the downs and ups with you. But if your business model is losing steam, you may be out there

alone trying to do business in a way that no longer works, while the others rush by you. Pay attention to the cycle of your business model.

The current destructive price model or flat yield curve is expected to change for several reasons besides a simple regression to normality. According to Slywotsky, leasing companies, like companies in any business, begin to exit “no profit” zones, lines of business, practices or even customers. Identifying “no profit” zones begins with understanding how profit happens in the equipment leasing and finance business and then adopting a profit model and sticking with it. See Figure 2.

What model will bring a company profitable growth? Most member discussion of this issue this spring relates to scale, bundled services, providing solutions and more residual based business. Time will judge.

Slywotsky recommends that companies begin to develop a business model (a profit model) by looking through the customer’s eyes. “What can the company do to help me, to solve my problems?” This question in turn lets the equipment finance and leasing company focus on all of the potential ways the company can improve its customers’ economics.

Slywotsky presented an index to help analyze the power between customers and suppliers (equipment finance companies) as a guide to developing a profit model, Figure 3.

This spring, leasing executives’ comments indicate a view that the business today, as a whole, is at the *weakly differentiated* mode. Captives are seen as the winner here because of the brand identification of the equipment, integration with the channel partners and a trend towards “giving



Jamie Barrette, Mercuri International, leads an Executive Roundtable discussion of the factors that influence sales results.

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away” financing to move equipment.

### **2. How do I address my personnel needs?**

Attracting and retaining personnel has long been a source of discussion. However, the discussions and actions are becoming more specific. Companies want experienced people, and there has been a reluctance to recruit inexperienced people and train them. This situation has created some very aggressive practices, including aggressive offers to key people to get them to move, with high salaries and making bonuses good even in mid-year moves. To hold people, companies are

now more likely to match rival offers and consider retention bonuses.

But there is evidence that major companies will put more resources into training and development to create talent. If you cannot hire an experienced salesperson, for example, put more resources into transitioning a relatively new salesperson or other employee with intrinsic abilities into an experienced one. This is not inexpensive, but it is more productive than the cost of trying to find experienced people and attract them to your company. The shortage of new talent means that that talent must

be developed. *Farming* may have to replace *hunting* in attracting and holding talent.

In March, ELA put out a call to develop a Human Resources Advisory Committee to work with the association on a number of competency programs and create a network for HR people. It was immediately over subscribed and an enthusiastic initial meeting was held. Most of the focus of the meeting was on improving/developing training and education activities, and it addressed ELA's new web based training programs now in development and the attraction and development of new, younger people into the equipment leasing and finance business.

Another sure indicator of the growing importance of training is ELA's *Principles of Leasing* workshops. Attendance has shot up in 2006 and there are increased calls to ELA for in-house customized training activities for employees.

Sales staff is where the largest personnel shortage is found. In a session at the Executive Roundtable, leaders from Mercuri International discussed sales, sales strategy and sales management based on survey work done with equipment leasing and finance industry executives (see article elsewhere in this issue).

It is possible to get more from sales personnel and develop highly competent sales staff. Presenters stressed the need for making it very clear in a sales strategy what the company wants in terms of product mix, revenue, profitability and customer mix. They further stressed that companies cannot be reluctant to grade or rate people—keep the best and get rid of the rest. For example, there is research evidence in financial sectors

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that 60 percent of sales people underperform and 40 percent over-perform. Twelve percent of over-performers actually achieve 50 percent of the results. This indicates a great need to work on underperformers. The biggest problem that became evident in the discussions, which involved more than 60 people, is that many companies don't have a good handle on what is going on with their sales people, what they are actually doing to implement a sales strategy and achieve sales objectives.

A survey of 43 ELA member companies by Mercuri has found that the top three strategic sales issues are:

1. Value selling
2. Consultative selling
3. The sales process

Resolving these issues is not easy and requires careful sales management, training and focus. Effective sales is knowledge and skill based. Value selling is based on whose perception? The customer! This has to be taught, trained and reinforced. Top sales peoples share certain characteristics such as *likeable, posses customer knowledge, good time management, fearless, have belief in and knowledge about products, flexibility and versatility*. Some of these traits are internal but others must be taught and managed through effective sales management.

### 3. What Funding Strategies are available to my company and

#### which is best for us?

Super liquidity is too general a term to describe the funding picture or create true understanding. The funding story is really about the following four points raised in previous *ELT* articles this spring:

- Equipment leasing and finance companies are in favor due to stability in growth, portfolio quality and yield. This factor trumps all others because, with large amounts of money to be put to work, businesses "in favor" are in advantaged positions.
- There are a growing number of alternative strategies that have lifted most companies past the traditional models of discounting, limited working capital to build portfolios and IPO's.
- The alternative strategies involve more than just funding transactions, they now permit risk management and greater growth. Greater use of commercial paper, securitization, portfolio sales and syndication are allowing much more sophisticated development of companies.
- Among the areas of greatest interest are an increase in private equity participation in companies or portfolios (thirteen significant participations since 2002), hedge fund participation in companies or portfolios (six significant entrants

since 2002), accessing industrial banks and increasing exploration of ties to REIT's. In addition, more company leaders are shying away from an automatic consideration of becoming a public company.

Strategically, companies are using this strong point in the liquidity cycle to build a variety of strong funding relationships in a multi-dimensional strategy. Some observers believe that the current super liquidity cycle is past its peak.

M & A activity is moderate for a variety of reasons. Buyers are very disciplined and the number of attractive companies is limited due to changes in acquisition strategies. There is less talk about scale driven acquisition and more about sector acquisition.

#### **4. Do we have the correct "risk management" mindset?**

This question actually reflects what I do not hear directly. Companies do not appear to have in place a process for regularly looking at themselves from the outside in for vulnerabilities. Put another way, the question is, "Where are we vulnerable?" I do hear discussion concerning the flat yield curve, high portfolio quality and the over-used quotation, "We see risk as opportunity," but I am not confident people know what they mean by that.

Recently I had the opportunity to have lengthy briefings at both NATO Headquarters and SHAPE Headquarters. I was impressed. I was particularly impressed how none of the analysis and planning took anything for granted. They had means in place to assess every risk associated with their mission and have a plan to deal with them. I wondered if the same could be said of the many companies ELA has the privilege to represent.

Do we truly see risk management

## **I often hear the over-used quotation, "We see risk as opportunity," but I'm not confident people know what they mean by that.**

as an opportunity or as a burden? Risk management, including thorough risk evaluation, can be an asset. It can be a differentiating factor. It allows a company to be on the cutting edge of change. Just think briefly about the basic categories of risk in your company:

- Strategic risk. This is the biggest risk because it is the risk that your business model and implementation strategy are no longer correct. The customers, the markets, the channels and the products pass you by before you know it.
- Operation risk includes both organization strategy and processes. Are you using technology thoroughly? Does your organization have access to the right skills to make your model and strategy work? Are people organized properly? Is management and communications set up to effectively implement your strategy?
- Social/business risk. As mentioned above, the world is changing. Transparency, fairness and simplicity are major trends in our society, including in the business culture. How does our company measure up? Are our practices and documents at risk? Social/business risk also includes legislative and regulatory changes that are likely to occur and how well we are able

to comply.

- Financial risk. This risk appears to be best understood by executives and receives most of the attention. It includes the basics including funding, portfolio management, credit analysis, tax management, residual asset value and portfolio quality.

### **As Good as it Gets?**

In a presentation this spring, Eric Hanson, Managing Director at Lazard, described the business as "As Good As It Gets." Great news and most indicators support that description. But Eric certainly didn't mean that things are headed downhill from here. As good as it gets is something on which to build, not defend. What leadership requires is the ability to make the decisions and take organizations forward to another place—that place we'd want to be if we had had a crystal ball three to five years earlier.

Strong companies will adopt a balanced strategy of looking ahead to the future they are certain will exist and ask:

1. Where do we need to be?
2. Can I get there?
3. What do we need to do?

Get going! **ELT**

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