Equipment Finance

Time for banks to bring it back into the mainstream?

The biggest issue facing SMEs and middle market companies is sourcing the working capital to fund and grow their businesses. Given this is the "sweet spot" in the business lending market right now, banks have focussed their attention on providing more flexible and reactive working capital solutions to these ambitious businesses. But one area which seems to have escaped the attention of many commercial banks as they streamline and restructure their lending models is Equipment Finance.

The Big Four banks do provide equipment finance of course but they tend to be quarantined in subsidiary divisions away from the mainstream lending business, such as ANZ's Esanda. But while many of the banks have split equipment finance from the rest of their lending, SMEs do not differentiate it from other funding solutions. What's more, SMEs looking to grow to the next level are happy to pay higher interest rates if it means they can secure funding. Mainstream banks have also been hindered by tighter credit policies and the need to take into account the business earnings of the companies they lend to. This has created the space for providers such as GE Commercial, with different approaches to debt to step in and gain quick traction. Recent research by East showed that almost two thirds of businesses across Australia thought of GE first when it came to equipment finance. GE might be the behemoth in the market place but there is also a proliferation of small providers and intermediaries playing in this lucrative working capital and cash flow financing space, all of whom are chipping away at the commercial banks' margins.

Bank of Queensland has made equipment finance a central pillar of its business lending arm, and grew this part of the business by 38 percent in 2005, on the back of its UFJ Australia purchase. The vast rump of BOQ's equipment finance business has been originated through the broker channel, the traditional source of leasing and equipment finance facilities for many years. As East has reported regularly over the past year, lending origination in the broker channel is exploding with almost a third of SME and middle markets companies using brokers to source debt and gain advice on the most flexible solutions. The principal reason given for why businesses source debt this way is flexible security/collateral arrangements. If banks do wish to play in the equipment finance space they cannot ignore this increasingly important channel.

Equipment Finance pie is growing

Banks need to consider the size of the market that equipment finance and leasing offers. Exhibit 1 below shows that after plain vanilla business lending, equipment finance is the second most sought after working capital solution, with a quarter of interviewees nominating it as a growing need. Leasing overall is growing in the Commercial, SME and Micro Business market segments and there is every reason to believe this will continue over the next 12 to 18 months if the economy remains robust. For businesses, leasing is tax efficient and keeps capital expenditure under control.

% of companies using Leasing

	Current	6 Months Ago
Commercial	66.5	65.5
SME	59.9	59.1
Micro Business	40.1	38.8

Interestingly, for a business which is mature and essentially a plain vanilla product, the customer satisfaction ratings for the equipment finance market as a whole are extremely ordinary. Using East's reverse 1 to 5 scale (where 1 is satisfied and 5 is dissatisfied), overall satisfaction with equipment finance only rated a very poor 3.63. This is a surprising outcome and adds more fuel to the fire for banks to consider bringing equipment finance back inside their main business and integrated with their working capital divisions.

Figure 1

Products Most Commonly Increasing in Terms of Customer Need

	% of Commercial Enterprises Reporting in Top 3 Product Increases
Deposits & Investments	
- On Call Accounts	2.0
- Term Cash Deposits	7.1
Business Lending	81.6
Equipment Financing	25.2
Transaction Banking	21.9
Merchant Services	24.2
Trade Finance	18.2
No areas of notable growth in demand being experienced	24.5

Note: sums to over 100 percent due to multiple responding

Figure 2

Types of Equipment Finance Being Used

	% of Commercial Enterprises with Equipment Finance
Leasing	51.6
Rental Agreements and Operating Leases	11.0
Novated Leasing	6.0
Commercial Hire Purchase	2.9
Luxury Motor Vehicle Lease	4.4
Chattel Mortgage	1.4
Revolving Limit	3.9
Other	18.8
TOTAL	100.0