Managing Your Assets: the Benefits of Leasing

In today's interest rate sensitive environment, industry studies indicate that an increasing number of companies are considering equipment leasing instead of an outright purchase as a way to enhance cash flow performance. Yet, according to experts from the Wharton School of the University of Pennsylvania and from GE Commercial Finance, a buy-or-lease decision also calls for careful analysis. While leasing can provide certain savings and other benefits, an individual enterprise should also closely consider its own unique operational and financial requirements. The wide array of available leasing options can deliver significant value to a business and should be explored before a final decision is made.

Cash-flow, Other Concerns Help to Drive Equipment-Leasing Activity

Today's business market is characterized by rapidly evolving technology that pushes companies to make increased investments in machinery and equipment even as CFOs try to rein in spending, notes Anthony DeVito, a Senior Transaction Manager at GE Commercial Finance.

“More companies than ever before are being judged by their cash-flow activity, as opposed to their accounting earnings,” he says. “This has driven more CFOs to consider leasing, which can reduce their monthly outflow of cash.” That trend is reflected in the 2005 Survey of Industry Activity released in August by the Equipment Leasing Association. According to the ELA report, new equipment-lease volume in 2004 was more than $105.2 billion, an 11.7 percent increase over 2003 levels.

The ELA survey tracks a wide range of leased equipment, including agricultural, aircraft, construction, computers, telecommunications, railroad, printing, medical, industrial, trucks and trailers.
“Buying equipment either through an outright purchase or through loan payments that historically are higher than lease payments has a greater, immediate impact on cash flow,” notes the ELA. Leasing usually has a more favorable impact on cash flow due to the lower payments.

Leasing also offers a variety of benefits that can enhance productivity.

“Generally, owners must manage the disposal or selling of outdated equipment, which can slow down the upgrade process,” reports the ELA. “Leasing allows for easier upgrades, including master leases that allow for additional equipment to be acquired under original terms and automatic upgrades to new equipment and technology.”

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GE's Value Delivery Goes Beyond Financing Expertise

The Equipment Leasing Association suggests that a company should consider how it plans to use an asset before it enters into an equipment lease. Management should also gain assurance that the leasing representative understands its business, and the way in which the leasing transaction will help it to do business. DeVito notes that GE's At the Customer, For the Customer (ACFC) program leverages the lender's experience in manufacturing and financing.

“Before they recommend a financial solution, our trained ACFC specialists gain a deep, thorough understanding of a customer's needs,” says DeVito. “The goal of ACFC is to bring the entire GE toolkit of business improvement tools and methodologies to customers; to drive cost savings, productivity and revenue growth.”

“The issue regarding equipment acquisition is not really just a 'buy-or-lease' one,” explains John McAuliffe, Manager, Marketing & Sales Support, GE Commercial Finance. “Instead, it can be framed as a question of ownership and optimum decision timing whether an enterprise needs to own a capital asset now, or defer ownership to a future period if that will deliver more value. The strategy may vary by company, by industry, and by type of asset.”
In some cases, a company will be better off taking up-front ownership of an asset either because of internal policies, or because the firm modifies the equipment to its own specifications.

“But in some cases, leasing can offer more options,” notes McAuliffe. “For example, if an equipment lease is structured properly, it will give the company the ability to utilize the benefits of using an asset in the present, while deferring the option to own it until a later date when the firm has more accurate usage intent and financial knowledge and can make a better decision about whether or not to acquire ownership.”

He adds that GE Commercial Finance, Business Financing Solutions structures a range of tailored equipment lease programs with terms that are crafted to meet companies' cash -flow, operating and other needs.

McAuliffe points out that leasing programs can be optimized to fit a number of situations.

“Equipment leases are often designed to meet one of two situations,” he says. “In one case, a customer may plan to use the asset for a limited amount of time, which makes the economics the primary consideration. In another case, a customer may find it desirable to own the asset at some point, but does not yet know when that point will occur. In this situation, a lease offering a customized purchase opportunity unique to the customer's needs may be structured. If the customer has specific cash outflow concerns, the transaction may be structured with a pre-determined, known, purchase price, taking the financial guesswork out of the deal; and offering a specific buyout option date. Other options may also add flexibility."

"An equipment lease may offer more flexibility than an outright purchase," observes William C. Tyson, an associate professor of legal studies and business ethics, accounting, management, and law at the Wharton School of the University of Pennsylvania. "It can deliver low up-front expenses, while preserving capital."

The decision about a lease or purchase may also be influenced by industry, investor and other considerations. "Businesses in such capital-intensive industries as construction, and cyclical or seasonal ones, such as ski manufacturers, are taking more of interest in leasing solutions," says McAuliffe. "Management in such businesses likes the fact that a lease can be structured to reflect a company's cash management needs, aligning revenue outflow with inflow. This is also increasingly important to the media and broadcast industries, which are often judged by their cash-flow and liquidity performance."

He notes that the cash-flow benefits that come with leasing can help companies to align their financial-statement profits with their net cash position, delivering confidence to stakeholders.

"Large and publicly held companies acknowledge that investors favor the flexibility and transparent nature of equipment leasing," he reports, referring to leases that appear on a company's balance sheet or within footnotes. "Meanwhile, smaller companies find the financial liquidity it offers helps them to weather economic ups and downs." The ELA notes that an organization that buys equipment must also manage all related maintenance costs, interest, taxes, and insurance. But many leases shift the financial burden of the maintenance costs, interest, taxes and insurance to the lessor.

"For many companies, the ability to stay competitive hinges on acquiring new equipment but financing such acquisitions may be hindered by existing lending covenants that restrict their ability to take out new loans," adds McAuliffe. "A lease may deliver leverage that lets an enterprise acquire machinery and equipment while meeting the contractual obligations imposed by its other financing sources."

The lifecycle of an underlying asset may also play a role in a company's lease-or-buy decision, suggests Wharton's Tyson.

”If the leased machinery or equipment utilizes computer or other technology that's likely to improve significantly in a short period, a lease arrangement may be better since it places the risk of obsolescence with the lessor instead of the lessee,” he observes. “Such rapid change is common with computer-based technology.”

“GE's heritage as a manufacturer gives our specialists the ability to understand customer needs from an operating point of view as well as from a lender's view,” says DeVito. “Unlike some financial institutions, which operate in a rigid manner, the needs of our customers drive our deals.“

Knowing the impact of asset acquisition upon an asset user --the effects on revenues and costs; sensitivity regarding cash flow, liquidity, capital management, after-tax impacts, ownership timing, technology forecasts and usage timing all contribute to a business becoming comfortable with its decision to purchase now or to lease now. This results in a very helpful positive working relationship with the financial provider regardless of whether a lease or loan is contemplated.