40 YEARS OF THE UK LEASING INDUSTRY

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It is very flattering, not to say a significant 'age reminder', to be asked to record my thoughts on the progress of the equipment leasing industry during the last 40 years. This coincides with the 40th Anniversary of the World Leasing Yearbook.

The development of the World Leasing Yearbook during these years has been a great contributor to the global leasing industry, not only detailing the progress of leasing country by country, but also ensuring contact and the flow of information between the players in each country.

The early years

Perhaps before looking at the progress of the industry since 1979, it may be useful to the reader for me to summarise the start of the industry in the UK and Europe from its beginnings.

In 1960 the industry got under way in the UK with the entry of United States Leasing Corporation of San Francisco forming a joint venture with Mercantile Credit in the formation of Mercantile Leasing; quickly followed by Schroder Leasing, Astley Leasing and others.

The industry's rapid expansion in the UK was followed by new European ventures starting up in France, Germany, Spain, Italy and Scandinavia and this took us into a never-ending growth mode. European leasing was on its way and at the same time the finance industry was discovering the differences between this new form of lending and traditional banking products.

I had the rare privilege of early entry into the UK business in late 1960 joining Mercantile Leasing and opening its new office in Leeds. The similarities between the two owner organisations and indeed between many of the other new entrants into the business such as Schroder Leasing, Anglo Leasing and others, was that they did not have any natural customer base, unlike the banks. Their flow of business was being created by relationships with suppliers of equipment, manufacturers, suppliers, agents and sales outlets. This continued, forming the beginnings of 'sales aid' (or vendor) leasing and was the start of a very substantial and exciting new business.

The acceptance of the leasing concept

Sales of equipment were made easier with the introduction of the idea that a user of equipment could pay a monthly rental rather than a substantial amount of money for the purchase of the equipment. This was different to 'borrowing' as the rentals were 'tax deductible' in most jurisdictions and also the owners of the equipment, the leasing companies, were eligible for tax deductions by way of 'capital allowances' for making the investment in equipment. Tax deductions of this type were available in most jurisdictions in one form or another. This enabled some interesting new features to be introduced which many businesses had never previously seen.

Much of the growth of the industry, particularly for high end and expensive equipment, was driven by the tax implications measured by the then newly recognised 'present value' of 'cash flow'. Interest rates were relatively high and corporation tax was also significant. So much so that the apparent interest rates contained in a lease were substantially lower than similar borrowing costs. This was an illusion as the earnings of the leasing companies benefitted from the various tax implications which, in the main were shared with the user, the lessee.

Banks and lenders also recognised a new phenomenon: ownership of the equipment was much better than merely taking a 'charge' on equipment in the event that the 'borrower' got into difficulty. To add to the attraction of leasing, the transactions were, in most jurisdictions, 'off balance sheet' for the borrower. In addition, the banks started to recognise that leasing, with its tax implications, needed to concentrate on after tax earnings and not just pre-tax as previously and tax clauses were introduced into the documentation in 1971.

The secondary banking crisis

Prior to our 40-year starting point of 1979 there was a major crisis - 1974 brought an earthquake in the form of the 'secondary banking crisis'. This was a systemic failure of a number of the secondary banks, who were primarily known at the time in the UK as the Finance Houses. The problem had arisen out of the funding mechanisms of the Finance

Houses, whose main business had been the dealer financing of cars, vans and trucks as well as household appliances.

Much of their business had been relatively short term, and a movement in their business towards longer life transactions brought with it the temptation of borrowing short and lending long. A drying up of liquidity in the market brought about severe problems for the sector.

Fortunately, at the time the Bank of England had the mechanism of "Fireside Chats", not something admired by the present-day incumbents, however, very effective when done well. The result was that many of the Finance Houses were taken over by the major banks at the behest of the BoE and the leasing business became a part of the portfolio of products offered to customers by the bank branch networks.

The major Finance Houses in the UK at the time were United Dominions Trust, Lloyds and Scottish, Mercantile Credit, Lombard and North West Securities. As the newly created environment became established the major UK players in the leasing market became Midland Bank, Barclays Bank, Lloyds Bank, and NatWest Bank. Some slightly smaller players, but also significant, were Yorkshire Bank, Bank of Scotland, Royal Bank of Scotland and an interesting partnership, Airlease International, managed by Kleinwort Benson. This was also the start of the 'Big Ticket' leasing market.

Regulatory changes

Governments and regulators started to get interested in the leasing business in the late 1970s and early 1980s and began to look carefully at the business models which sustained the leasing business, particularly 'tax consolidation' in banking groups.

The first major discussions about how to account for leases was the subject of many Leaseurope conferences, dominating the proceedings and producing the airing of extreme views. The German position was to follow the legal interpretation of the transactions. They proposed that the 'ownership' of the equipment prevented the user from capitalising it on their balance sheet and many long hours were spent trying to persuade other countries to follow their logic.

The German view did not succeed, and the German leasing association came into line with the rest of world as the International Accounting Standards Board started to develop new rules together with the FASB, the Financial Accounting Standards Board of the US.

ELA 1989 Annual dinner. From left to right - Neil Grant, Director General ELA, Derek Soper, Chairman ELA, Guest of Honour Sir Leon Brittan, European Commissioner for Competition, Neil Benson, Chairman, Godfrey Davis Holdings, David Beever, Member of the ELA Board and Brian Hassall, Vice Chair ELA.

Changes were rapidly coming in the late 1970s and 1980s. Governments were against banks enjoying deferred tax (exchequers wanted the money now, not wait a long time for it) and they changed tax rules and gradually the benefits of 'tax allowances' and the opportunity to defer tax were reduced or eliminated.

In the UK the entry of the merchant banks into the business gave a boost to the inventiveness associated with the industry. Tax management of many of the large corporations was undertaken by the merchant banks and this resulted in equipment on lease being owned by some of the largest companies which otherwise would not have been involved in the 'lending' business. These were a wide assortment of companies such as Marks and Spencer, Distillers, and the GUS Group.

Entry of the consultancies

The entry of various consultancies was driven by the need for knowledge and structuring expertise, in many cases these were individuals who has previously worked in the leasing industry and saw the opportunity to structure transactions and take fees. The size of the transactions being undertaken, such as satellites, aircraft, power stations and water processing plants, were sufficiently large to provide a good living for many of the consultancy/broker/arranger fraternity.

The main players in the UK were MDT (Ross Mcauley, John Dennehy and Chris Tolley), Babcock & Brown, National

Leasing and Finance and Spectrum Capital. All were greatly admired and to some extent envied by the industry.

As the tax advantages began to be reduced by governments the sophistication of the transactions became a key to their survival. Lessors became specialists in certain types of equipment and were willing to take 'residual value risk' i.e. the total rentals charged for a particular item, for instance an aircraft, were considerably lower than a full repayment of the total amount invested.

The residual value taken by the lessor made up the difference between the rental due and the total cost of the aircraft. This became a very large business and was subsequently absorbed into the various bank corporate finance departments and project departments. This type of business is no longer considered to be 'leasing' but is more likely to be considered 'project financing' or specialist finance and undertaken by the corporate finance divisions of the major banks.

New entrants

As with any large business opportunity there are new entrants and the end of the 1970s and early 1980s saw many newcomers from overseas at the same time as many UK companies were developing subsidiaries overseas. The leasing business attracted incomers into the UK market from the US and Europe, and also a number from Japan. Their reasoning was varied, but initially driven by their domestic customer base and the idea of continuing to support known customers irrespective of location seemed attractive.

Some of the US banks were interested in expanding their product range and used leasing as an added attraction. Chase Manhattan, Security Pacific, Bank of Boston and Bank of America were amongst the first to set up operations in London. The new contenders from Japan were more targeted and with their very large resources made considerable headway in the larger projects.

The main entrants from Europe were the French and German banks, some of whom are now well established in the UK such as Societie General, BNP, and Commerzbank, plus DLL from the Netherlands for example. These organisations now dominate the international sales aid (vendor) leasing market, operating in a multitude of countries and supporting the sales of equipment via a wide range of manufacturers.

My main memories of those times were the patience and dedication needed to learn and understand the cultural differences of the various countries. Although the business was similar the differences in interpretation was driven by the basic cultural differences. Surprisingly, I found the cultural difference between the UK and the US more marked than those between the UK and France. There was a tendency for the US companies to believe that 'if it was ok in the US then it must be OK in the UK'; whereas the UK and French started from the basic knowledge that there were differences which needed to be understood and reconciled before getting into commercial relationships with each other.

As the number of players increased there was a tendency to try different business models to gain competitive advantage. The cross-border transaction seemed to be the answer to many, it would use existing systems and, in many cases, it would use a 'same currency' arrangement.

However, not all was smooth or easy as many countries have tax protection against such transactions by way of 'withholding tax' on rental payments. It is a product which has been looked at over the years, but rarely used except where there are other advantages, for example those where a 'double-dip' into more than one jurisdiction can produce added tax depreciation advantages.

The business environment

It is interesting to reflect on the business environment at the beginning of our 40 years and compare it to today. From a leasing point of view the two main co-ordinates during the early years were cost of money and Corporation tax rates.

In November 1979 UK interest rates were 17%, coming down to 0.25% in August 2016. (At the time of this article interest rates are 0.5%). Corporation tax in the UK in 1978/79 was 52%, in 1986 it came down to 35% and it is currently at 19%. In this low tax, low interest rate environment the investment decisions of industry seem much simpler.

Looking forward, it does seem that a higher rate environment will take some time to return and Brexit considerations may keep Corporation tax down to the low levels we are currently experiencing. The industry has continued however, although much of the current business is at the smaller end of the market and established amongst the SME sector, much of which is generated by the broker market.

Changing business relationships

As I reflect on the differences which have come about over the 40-year period of the industry, my main thought revolves around relationships coupled with the advancement of political correctness. The late 1970's and 1980's was the very best period I have experienced in the leasing market, in that ▶

MANILA LEASING CONFERENCE

This was the first slide (above) of a presentation I prepared for a "Leasing Digest" Conference held in Manila, Philippines. The subject was the tax and legal implications of leasing worldwide! Really boring!

I created a Mr Equipment and a Mr Receivables to demonstrate the two different approaches to each of the subjects with one looking at leasing as a financial product and the other looking at it through the eyes of an equipment manufacturer, and therefore a physical asset.

We did a very sophisticated (at the time) slide show – four stacks of slides in carousels with music – Close Encounters of the Third Kind and Star Wars. The whole thing represented as a space odyssey, even the questions were represented by question marks flowing through space.

We sent two boxes of slides to Manila, one by BA and the other by Philippine Airways. We never saw the BA package again and the other one was held by customs in Manila. On the morning of the conference we had it released by telling the authorities that the first speaker of the day was their Finance Minister. I was on right after him. Needless to say, the package was released!

the 'togetherness' of individuals across the industry was quite remarkable.

The first industry magazine covering the leasing industry was Leasing Digest (the sister publication to the World Leasing Yearbook) which was set up by Robert Hawkins in 1977. This was the industry bible at the time, and it spread the word on leasing through the magazine and a series of conferences around the globe. The 'Digest' was sold to Euromoney a decade later in 1987.

Sadly, the demise of Leasing Digest after its acquisition was as a result of losing its close personal connection with the industry. The original team at the Leasing Digest knew the industry players very well and nurtured those connections so that comment, stories, anecdotes, from the industry were reported in a sympathetic way and confidences were respected. In other words, all of us in the industry trusted and appreciated the camaraderie reflected in the reporting.

The UK Equipment Leasing Association at the time was a very tight-knit group and deep-rooted discussions amongst member companies, and also with UK Government agencies such as the Inland Revenue, Bank of England and Treasury, were a driver which encouraged co-operation between various leasing companies.

Many large transactions were shared amongst three or four companies and this was also an encouragement to a very close industry group of individuals. The move which amalgamated the ELA with the FHA (Finance Houses Association) to form the FLA changed that dynamic in two ways.

Firstly, there was a mix of business products and these were represented by quite different groups of individuals within the various member banks and institutions, and secondly, the direct relationships between the industry representatives and the Government departments was replaced by the new "all singing and dancing" FLA management who were not a part of the industry and did not have the background knowledge of how the industry had evolved. We moved from 'practitioners' to 'autocrats' and hence we lost much of our influence.

Credit and banking crisis

The largest impact on the leasing business during the last 40 years does seem to have resulted from the credit and banking crisis of 2008. Until then the major banks and manufacturer captive finance companies around the world dominated the leasing market. The crisis left many of the large banks struggling with their capital resources. As capital became an issue the internal decisions were focused on 'return on capital' and survival of 'bread and butter' business as well as Central Banks insisting on 'domestic preference'.

Leasing has not featured well in those scenarios and many banks have retreated into support for their existing customer base, reducing support for overseas markets, retraction into simpler transactions and overall reduction in business volumes. Some of the business has been taken by the challenger banks via the broker market, but it seems evident that 'inventiveness' is lacking in the market and new sources of business are not being pursued as effectively as in the past.

However, the manufacturer captive finance companies are thriving and their growth has been dramatic during the past 10 years. It is a sector where the alignment between sales of equipment and services and the provision of some form of credit arrangement is paramount to the success of the sales and distribution effort of the manufacturers. The embracing of the service element in transactions is re-defining the types of financial product on offer, much to the benefit of the customers.

The next 10 years

Where do we think the market is going during the next 10 years? Unfortunately, there is already a lack of experienced individuals in the market and this dynamic will not change without the experience of actually doing complex transactions and inventing new ways of taking security and laying off risk.

This leaves us with the surge in managing companies by process rather than by individuals; there appears to be little or no delegation of decision making to individuals, but increasingly referrals to committees. All slowing down the delivery of service to customers or taking it away completely.

Sadly, looking in from the outside, I see senior management in the major banks as having little or no authority to make decisions and in many cases I do wonder if they have arrived at the conclusion that they no longer want that responsibility.

The growth area I see, as the reversal of this trend in the banking world, is that developing in the manufacturing sector – i.e. the manufacturers are, and will, find ways of producing additional services to their customers by offering an assortment of financing products. These services already abound in the world of 'sales financing' and are well established amongst the manufacturers such as Cisco, Dell, IBM, CAT, Volvo, John Deere, Xerox, JCB and many more, not least of all with the motor manufacturers.

I wish I could be around long enough to be asked to comment on the next 40 years!

DEREK SOPER

Derek has over five decades of experience in the international leasing and asset finance markets and has worked with leasing companies at all stages of development and maturity. He entered the leasing industry in 1960 with the establishment of Mercantile Leasing, the UK's first leasing company. In 1968 with two colleagues from Lombard he set up Midland Bank's new leasing company, Forward Leasing. In 1971 he was hired to launch Barclays Bank's first leasing company and during his tenure with Barclays Bank International he helped set up 19 subsidiary companies around the globe.

In 1981 he joined Kleinwort Benson, the UK's largest Merchant Bank at the time, as a Banking Director and Head of Leasing. In 1991 he established AT&T Capital in Europe, taking it into 13 countries; followed in 1994 by the establishment of AT&T Capital in Asia and the formation of a network of companies in Australia, China, New Zealand, Singapore and Taiwan.

In 1998 on his return from Hong Kong he started IAA-Advisory where he serves as Chairman. Derek co-founded the Leasing Foundation and currently support activities in both philanthropy and community as a Patron of the Asset Finance Professionals Association. (AF-PA) where we hold the industry's Annual Charity Christmas Lunch and raise funds for Macmillan Nurses.

Derek is a former Chairman of the UK Equipment Leasing Association (now the Finance & Leasing Association) and a former member of the Council of Leaseurope.