eBOOK

Vendor finance in the ‘new normal’ will depend on digital transformation

Q2

Digital transformation has been the buzzword *du jour* in almost every industry for years—but what does it really mean, particularly for equipment leasing companies? To unpack the generic term and understand how equipment leasing groups can practically move forward in using technology, we at Q2 believe the best place to start is by examining the challenges equipment leasing groups face.

Where are there inefficiencies in your underlying leasing process? Where are there gaps in your lessees' experience? At Q2, we believe technology has untapped potential to improve the processes by which leasing deals are designed and delivered. It's a complex business, but by focusing on a few key challenges facing leasing companies and lessees in today's world, we can establish where best to begin – or continue – the digital transformation process for equipment leasing.

Listening to our customers, we have learned what their customers need. They want fast, streamlined processing of tasks; data storage that can be accessed anywhere and at any time; and the flexibility to interact with their lessor or lender safely, simply, and efficiently. Today, with physical interaction minimized virtually overnight, people are relying on digital as a lifeline.

Perhaps more than any event before, the global COVID-19 pandemic has caused equipment finance companies to more urgently seek automation, adopt cloud solutions, and embrace more digital transformation to streamline vendor leasing programs, manage risk, and offer their customers and their end users more flexibility.

Long before the pandemic—spanning at least 25 years—vendor programs were key drivers of top-line-revenue growth for successful equipment finance companies. In recent years, new lease originations in the U.S. total more than $900 billion, with the majority being sourced through vendor channels.[1]

With vendor finance comes a significant challenge: Complexity.

Keeping all moving parts in motion

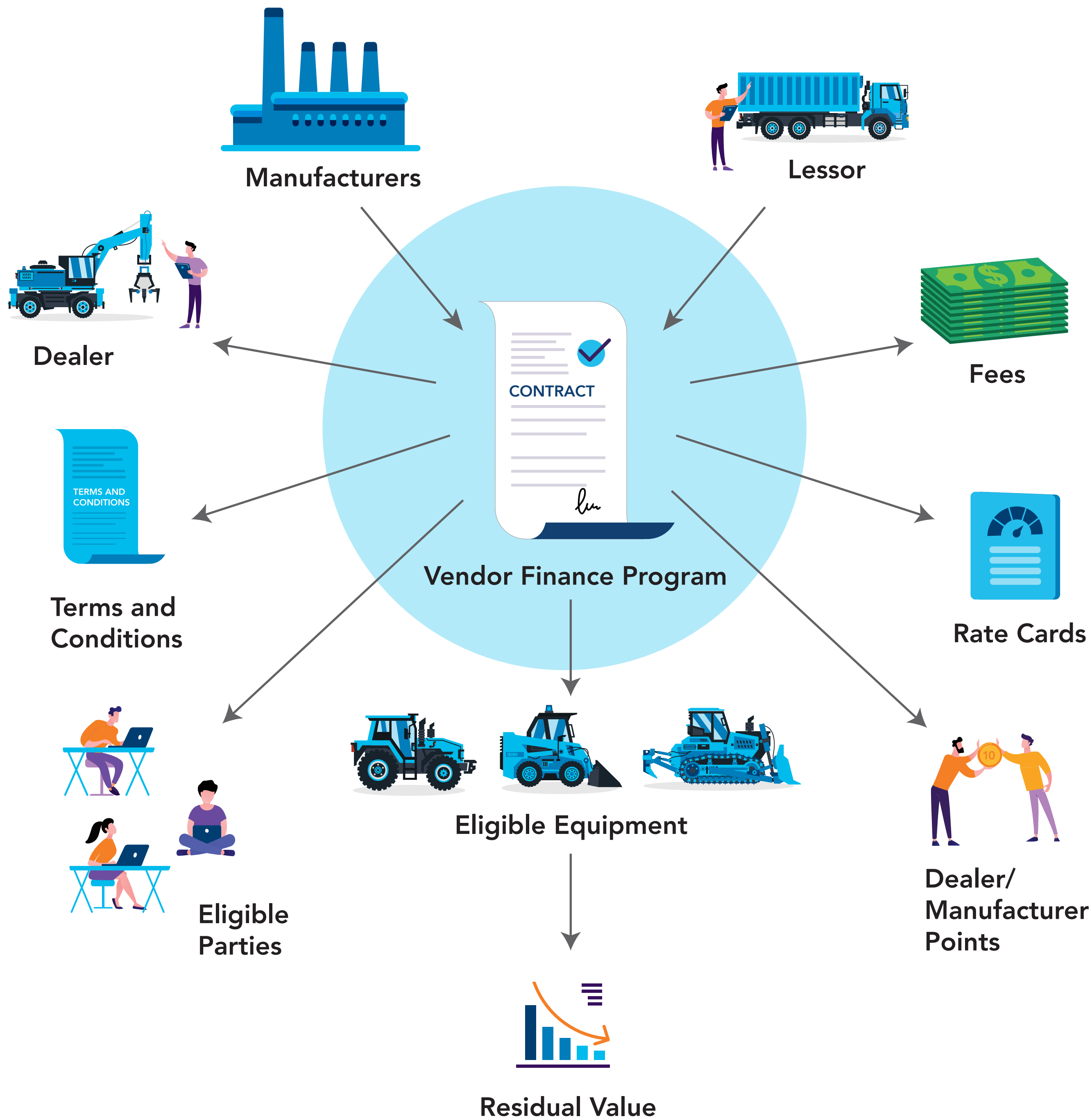
The simple truth is vendor programs can be complex and, therefore, labor-intensive to initiate, maintain, and scale. The typical vendor program has at least nine critical components, with over 100 variables. This complexity means the program often contains thousands of variations, each of which must be established, maintained, updated, and monitored for compliance and performance reporting—all in a dynamic and competitive marketplace.

For all the variations of each of the components, personnel are needed at each stage (from initiation through maintenance and reporting) to ensure a successful vendor program performs optimally. A successful program can require as many as 12 people using up to nine distinct spreadsheets and software applications to support the program. Steering a ship this big can be unwieldy and time consuming; making wholesale modifications and updating the programs can take up to two months.

This lack of agility results in unwanted but necessary staffing increases to manually support the program, as well as potential losses resulting from non-compliance of programs that have fallen out of date. Let's not forget the missed revenue opportunities due to outdated pricing and point terms and the limited ability to add new programs quickly. There are very few easy options for making vendor programs work without the personnel necessary to ensure their complexity is being managed at each stage of their existence.

Justin Tabone, senior vice president for originations at TIAA Bank, agrees that the emerging challenges from the COVID-19 pandemic are bringing the search for solutions to the forefront. In a recent *Monitor* article, he wrote:

"There is potential for an increased focus on technology as companies with employees working remotely will want instant access to their portfolio data and the ability to transact from proposal to purchase order through digital tools … Finance partners will have to become even greater subject matter experts on the markets they serve to ensure they are providing vendor partners with the right financing solutions to navigate through these challenging times, while also managing their own portfolio performance."[2]



The critical role of managed services

Managed Services, while slow to take hold, have become increasingly mission-critical to equipment finance, according to The Alta Group, a leading global equipment leasing and finance industry consulting firm.[3]

"As advanced software and technologies are incorporated into equipment to make them 'smarter,' maintenance is more difficult, so end users are demanding more sophisticated managed services contracts that can provide turnkey maintenance and support," according to the firm.[3]

The Alta Group further notes:

"Several implementation challenges are taking time to resolve, such as Internet of Things (IoT) enablement to capture key metrics and funder comfort around new contract T&Cs related to shared risk, performance issues, variable meter billing, and more. As a result, OEMs will look at vendor programs with a more critical eye and want to exert more control in the process. This is likely to push them to multi-funder programs to meet user demand for flexibility."[3]

Automation for efficiency

There's no magic-bullet solution, but automation can help reduce the headcount or redirect talent to other critical business functions.

A Typical lessor that utilizes programs has between **600 and 3,000 vendors.**

In our experience at Q2 Lending, a lack of program automation is the single most significant factor contributing to inadequate margins from vendor programs. This isn't surprising because a typical lessor that utilizes programs has between 600 and 3,000 vendors. Remember that each is added to and maintained by the appropriate programs manually, and updates take months to complete. Let's not forget about the operational inefficiencies and business risks caused by the necessary manual updating and use of homegrown siloed systems and workarounds.

Look to the cloud

The vendor services that will succeed in the "New Normal" of a post-pandemic equipment finance landscape are those with a demonstrated capability to adapt quickly and transform old, inefficient service models into new, digitally streamlined, customer-focused solutions.

Given these challenges, automation can make or break a vendor finance program. A cloud-based solution is ideal for gaining the light footprint, flexibility, and speed critical to a vendor program's success. Cloud-based solutions that are highly configurable—enabling automation across all vendor programs, components, contractual terms, and financials—are the key to ensuring accuracy, completeness, and effective communication across the value chain. And a system that fits into the Salesforce or other CRM ecosystem makes the integration easy for everyone involved in the equipment leasing and finance lifecycle.

The search for these solutions has never been more urgent.

Jim Kelly sees this sense of urgency firsthand as the pandemic has unfolded. Serving as the head of Wells Fargo Vendor Financial Services, Wells Fargo Equipment Finance, he points out, "Customers still demand advanced technology solutions, and our progress and commitment to create a best-in-class experience is unwavering." He also says, "We are building systems that provide a fully integrated customer experience from credit application to funding and throughout the life of the financing agreement."[2]

This digital transformation of leasing services—reflected primarily in a rising demand for usage-based leasing and automation—has gained a new urgency. According to Mukul Mittal, vice president of industry solutions - Leasing, Q2, current events have hastened progress toward a digital leasing model and turned it into a groundswell of demand.

Mittal ought to know. As a veteran of technology solutions in leasing and currently serving as Q2 thought leader on leasing technology, he has seen firsthand how the pandemic is driving a renewed demand for a complete digital transformation in leasing services. The movement toward usage-based leasing models and automation—the two cornerstones of a digital transformation of leasing—is no longer a long-term goal. In speaking with Q2's customers, Mittal has found the need is here and now and, for many of those customers, a matter of survival.

A usage-based model for the real world—in real time

In speaking with his customers, Mittal has learned that the COVID-19 pandemic has forced lessees to rethink and reprioritize how they weigh the value of the usage they are getting from their leased equipment. With the pandemic disrupting almost all the conventional metrics for weighing cost against benefits, there is a new urgency driving the transition toward a usage-based leasing model. Propelled by automation and transforming equipment finance into touchless, streamlined, more efficient operations, lessees in today's world understand that the flexibility of equipment lease payments tied to their usage of that equipment could very well determine not only how well they weather the current pandemic's impact on the economy but whether they can weather it at all.

"Business models are broken," Mittal says. He sees businesses starting to look at options where they can move to a pay-per-use model because cash-flow disruptions have them looking much more critically at expenses. Suddenly, a fixed monthly lease payment for a piece of equipment that has been rendered inoperable by the pandemic comes into clearer focus as a liability on their balance sheet. A usage-based lease model would better recognize the stark reality of idle equipment—and not penalize the lessee for that reality.

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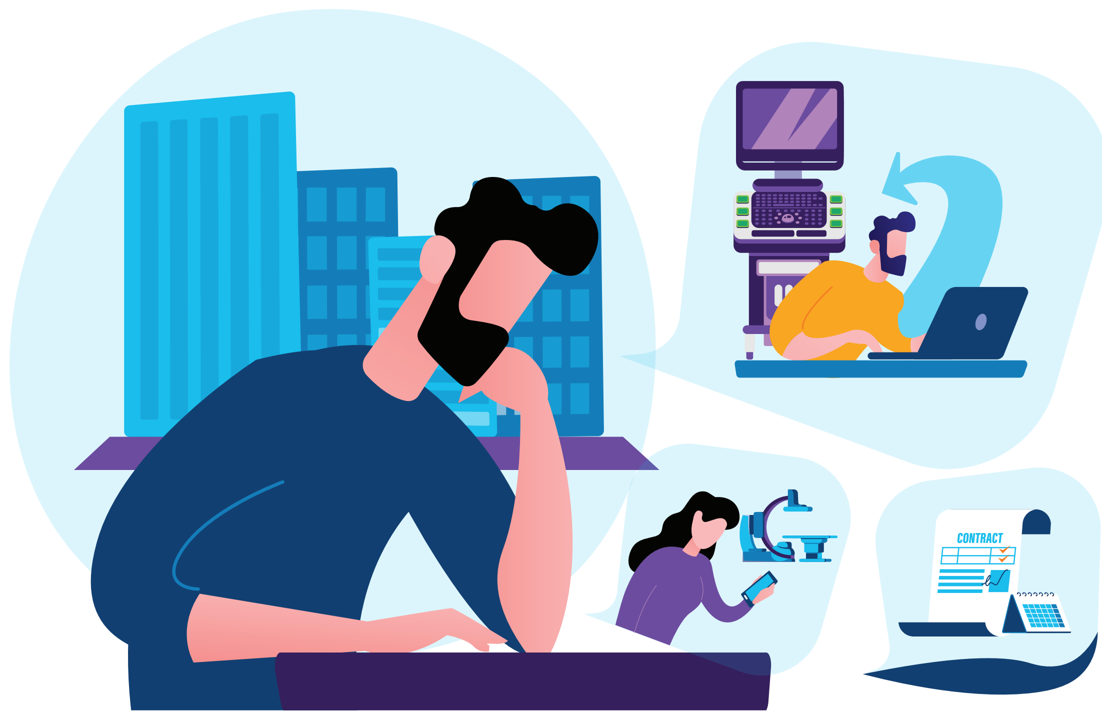


Mittal offers a hypothetical example of a dental practice. Dentists' offices are typically full of sophisticated, expensive equipment, almost all of which is leased. During the pandemic, mandatory closure has cut the usage of that equipment—in many cases, to near zero.

"Being required to keep cutting checks for a fixed lease payment every month has made it very difficult for these dentists to see that equipment lying idle," he says. "If they could flip their lease model into pay-per-use and have equipment shared among several other dentists, that would give them relief in times like this pandemic."

According to Mittal, many businesses are reevaluating their fixed expenses, including lease payments, and revisiting what equipment is central to their business model and how much they need to commit to paying to cover its use. "This evaluation is not unique to leasing, but the process of fixed payments for equipment is what everyone is reassessing. They are asking themselves, 'How can I sustain this outlay in the long term if the pandemic has a second burst of an outbreak?'"

How usage-based leases better serve lessees

Continuing with another analogy from the healthcare service sector, Mittal says a usage-based model would allow an MRI machine to be shared with five hospitals under a usage-based service agreement. "No MRI machine is in use 100 percent of the time, so fuller utilization will enhance its value to the lessee," he says. Mittal admits promoting this sharing of usage would be counter-intuitive for the manufacturer because it reduces the number of MRI machines sold. But he feels vendors need to rethink their business model to sell or lease under a usage-based model to generate revenue at a similar level.

"No one will be buying or leasing at pre-pandemic rates, so a usage-based model is the best alternative," Mittal suggests. "The investment climate is going to slow down and may take another year or far longer to rebound, so the only effective way to provide equipment is to do so on a usage-based model."

Justin Tabone from TIAA Bank agrees, per this comment made in the May/June 2020 *Monitor*:

"Vendors will require targeted finance offerings to [provide] customers just rebounding from the pandemic access to new equipment and technology. Additionally, there will be further emphasis on fee-per-service or usage-based solutions as budget-conscious customers may only want to pay for what they use."[2]

Beyond the demand for a new model for leases predicated on the usage of the equipment leased, Q2's lending customers provide Mittal with an invaluable perspective on some of the specific technologies they are seeking. The adage that "the customer is always right" bears new meaning today, with a leasing landscape more dynamic than ever before—and the stakes higher than ever. The time for a full digital transformation of leasing services has arrived, and automation is emerging as a key component of that transformation.

Automation for efficiency—and cost reduction

A new urgency is driving today's digital transformation of lease management, and automation for efficiency is increasingly seen as a crucial part of the transformation's success.

Beyond rethinking and reprioritizing the usage underlying the equipment they lease, lessees are welcoming automation as an accepted part of the changing landscape of post-pandemic lease management because of the enhanced efficiency—and attendant reduced costs—it can bring.

According to Mittal, no area for cost-cutting is sacrosanct among lessees today, so lessors and lenders must be prepared to meet ever-increasing pressure for ways to reduce costs. They must wring the maximum efficiency out of their lease management model if they are to remain competitive.

Tabone sees a similar demand for automation at TIAA Bank. "There is potential for an increased focus on technology as companies with employees working remotely will want instant access to their portfolio data and the ability to transact from proposal to purchase order through digital tools."

The stakes for meeting this demand are high, as Tabone further notes—"Finance partners will have to become even greater subject matter experts on the markets they serve to ensure they are providing vendor partners with the right financing solutions to navigate through these challenging times, while also managing their own portfolio performance."[2]

Quite simply, automation is key, and the pandemic has hastened the demand for it.

Transforming equipment finance into a touchless, streamlined, more efficient operation is not just a matter of allowing the evolution of a business model

"I definitely see the demand for automation growing because it is demonstrating its value," Mittal affirms. "We have customers who were able to migrate most if not all their systems to the cloud. For these customers, it took just a few hours for them to make the transition from operating conventionally to operating through a home-based model."

Such agility and flexibility are emerging as significant advantages today, and they are often being driven by customer demand, according to a survey of equipment finance companies and accompanying research report published recently by the Equipment Leasing & Finance Foundation. **"Customers are driving much of the digital transformation, with lenders often trying to catch up with or anticipate their demands. Some customers, particularly smaller ticket ones, describe themselves as having been 'spoiled' by the Amazon experience and now expect similar levels of service in other areas," the foundation reports.**[4]

The two main components of digital transformation

Mittal sees a complete digital transformation consisting of two components: one is automation, and one is cultural. "I think the culture part is huge. It's difficult enough to make decisions when you have a committee of 20 people sitting at a conference table trying to come to consensus; doing so when they are all working from home is impossible without technology to bridge the cultural gap," he explains.

In his ongoing communication with Q2's lending customers, Mittal has gained a clear view of the technologies and capabilities they are now seeking to facilitate work in the post-pandemic world.

"At a high-level, they are asking for ways to automate their most onerous tasks," Mittal says. This means finding ways to eliminate human interaction from any aspects of lease management that can be better handled through automation. "Every human touch increases the cost of doing business," he explains.

Mittal sees automation being most successful when it eliminates the most labor-intensive aspects of lease management. He has seen optical character recognition (OCR), for example, eliminate the time-consuming and expensive task of manually consolidating data, transcribing it, categorizing it for interpretation by an intended user, and packaging it in an easily accessible format. "If you could make this whole data-management process 'no-touch' that would be fantastic," the leasing technology thought leader says.

But the transformation toward automation must be extrapolated beyond just discrete tasks such as OCR if it is to have an appreciable positive impact on reducing costs and processing times, according to Mittal. Today's changed leasing world requires a new lease management model, and Mittal offers a glimpse of how this digitally transformed model might look.

"Ideally, in a vendor space, what I want is the vendor to put in a lease application through a self-service portal, have it automatically received by the middle office system, which conducts its credit adjudication process, and a decision is made for a yes or no—without anyone touching it," he explains.

If the lease is approved, then the lease documents are generated, and e-signatures are added. "When it comes back signed, the vendor delivers the equipment, and the lease starts," Mittal says.

Creating flexible solutions during the pandemic

Q2 has made substantial progress on improving the portal side and is currently focused on providing point solutions to banks, equipment finance companies, and fintech lenders.

Specifically, in response to a growing number of lessees requesting restructuring of their programs, Q2 created an automated solution for managing distressed leases and loans. With the demand for restructured contracts growing by the hundreds—if not thousands—in the face of the pandemic, conventional resource management was overwhelming lessors.

Restructuring each lease contract manually and individually was impossible, so Q2's automated lending solution enabled restructuring in bulk. Customers can now upload a spreadsheet of contracts to be restructured, and an automated restructuring solution facilitates the restructuring in three or four hours—versus the individual, manual process that would take the whole office several weeks. "Listening to our customers very closely and seeing what we could do to help was key," Mittal says. "And an automated solution proved 100% effective."

Mittal is an optimist. He has always relied upon listening to and understanding his customers' needs as the critical first step for adapting leasing models and implementing new technologies to support them. If the digital transformation of leasing services is to succeed, it has never had a better environment in which to do so—or one in which the stakes have been higher.

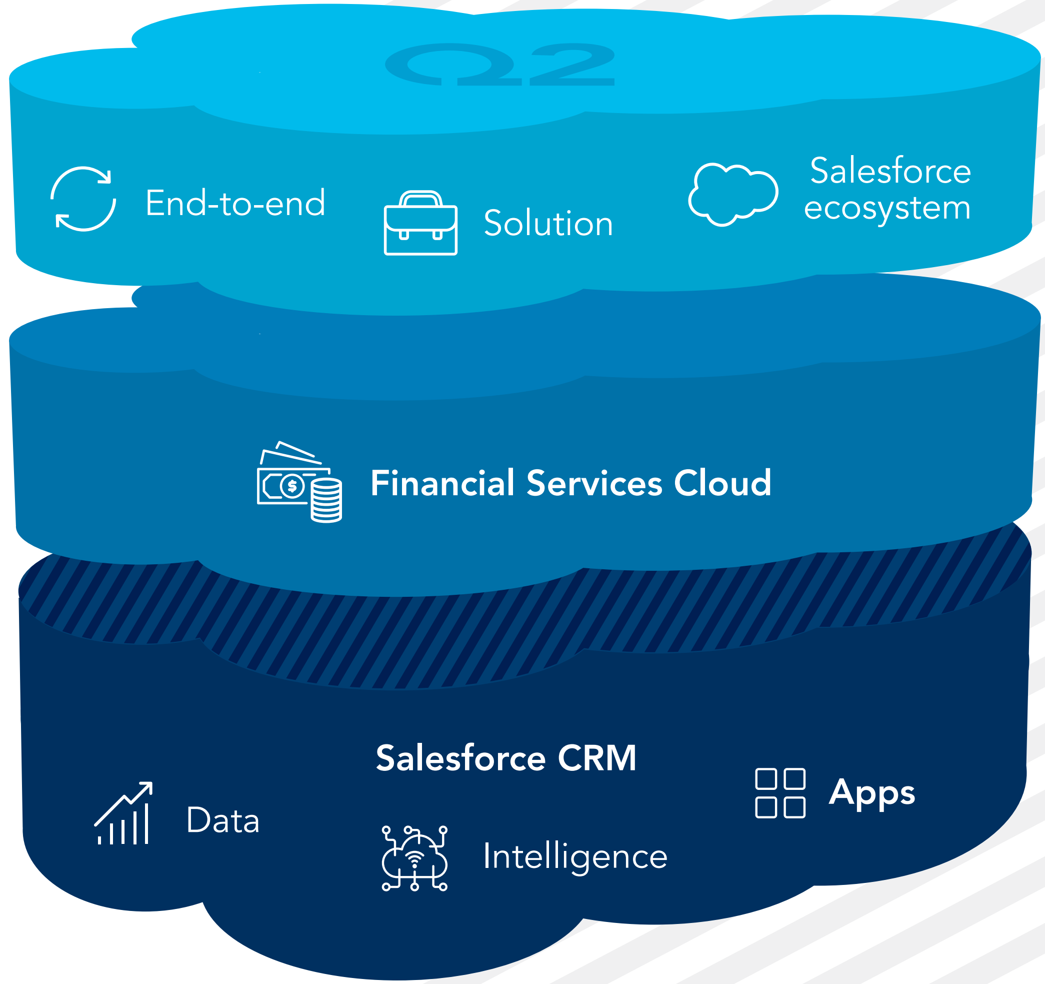
A transformation platform enabling integration

The success of any digital transformation is dependent upon the strength of its technological foundation.

In the case of Q2, that foundation is the Salesforce platform.

"The real power of Salesforce comes out in the ability to integrate," Mittal explains. "If you remember the older players in the leasing space, you'll recall that for them to build an integration into any of their solutions was a nightmare—really, really, difficult." Integrating front and back offices—and every other aspect of a lease transaction before and after, from start to finish—required an endless array of workarounds, patches, and fixes."

"Every customer had to do something unique on their own side," Mittal says. "Now, with Salesforce architecture and the way we are built, it's very easy to build these integrations." Mittal notes that the real value the Salesforce ecosystem adds is that it locks in the specific services a user wants, from lease inception all the way through the service-side, and automates them every step of the way. The most significant benefit, according to Mittal, is how much work it eliminates, adding that, "your users are just touching the exceptions."



Charting a path away from current challenges

If the uncertainty surrounding the pace and outcome of the COVID-19 pandemic is the only true certainty emerging from it, it may be helpful to try to focus on where the digital transformation could take us next.

For Mittal, getting to the solution will start with charting a path away from the current challenges. "With the pandemic, everyone is looking for ways to engage their customers better and more effectively," he says, citing solutions for the U.S. Paycheck Protection Program and U.S. Small Business Administration loans and managing their forgiveness as current top priorities. "That's where our energies are focused today: helping our customers innovate to provide solutions to their immediate problems," Mittal says.

Chris Lemone, senior vice president of sales for Amur Equipment Finance, sees flexibility and responsiveness as keys to success going forward. "Our core values of agility and adaptability are precisely what this time calls for. By staying true to these values as a company, as employees, and as partners to those we serve, we are confident in our ability to find the opportunities in this altered landscape and capitalize on them."[2]

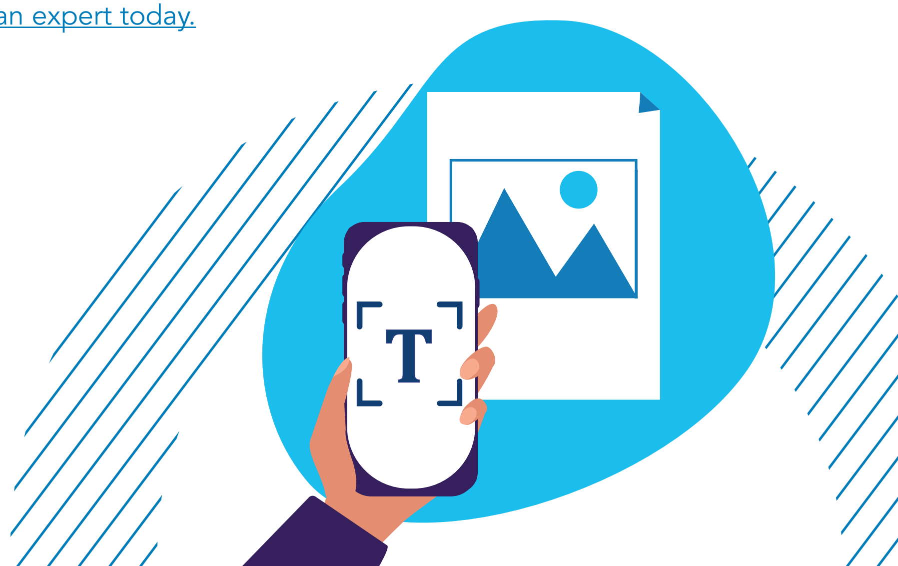
Beyond the immediate need to cope with pandemic-generated challenges, longer-term goals are still on the horizon. A digital transformation of leasing services will continue to add value even as the pandemic's immediate effects begin to fade.

Expanding new technologies such as OCR brings additional benefits, according to The Alta Group, encouraging their dissemination by breaking down barriers for their use and discouraging "siloing" within equipment finance companies. "Some innovations like OCR moved from one part of a company to another, an example of internal best practices at work. Digital's cost and complexity usually require a company-wide effort, rather than individual businesses or functional groups going in separate directions," The Alta Group reported.[3]

OCR is one technology that Mittal agrees holds great promise as a component of the transformation. "We have OCR on our roadmap," he notes. "We have done a lot of work on the portal side, but we are currently focused on providing point solutions to banks and institutions."

In whatever path we take to get to a digitally transformed leasing landscape, that path will have been created by establishing priorities, defining goals, and working toward attaining them. The technologies that prove successful will themselves be the foundation for a "new normal"—one that makes the most of efficiency and automation to reduce workloads and costs associated with lease services.

Need help simplifying your vendor programs?
Speak to an expert today.



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About Q2

Q2 is a financial experience company dedicated to providing digital banking and lending solutions to banks, credit unions, alternative finance, and fintech companies in the U.S. and internationally. With comprehensive end-to-end solution sets, Q2 enables its partners to provide cohesive, secure, data-driven experiences to every account holder – from consumer to small business and corporate. Headquartered in Austin, Texas, Q2 has offices throughout the world and is publicly traded on the NYSE under the stock symbol QTWO.

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