Financial Services

Financing the Future

A study of recent and future use of asset finance for equipment acquisition in manufacturing

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Key Findings

• Among the global top 40 machinery and equipment manufacturers, 76% have seen increased customer interest in using asset finance to acquire manufacturing equipment over the last two years.

• In the next two years, 93% of the surveyed original equipment manufacturers (OEMs) expect global interest in asset finance from their customers to increase still further.

• An annual growth rate of 5.1% is expected in Europe over the next two years, possibly the result of deferred investment demand being released.

• In the U.S., the proportion of manufacturing equipment sales enabled through asset finance has risen 2.1% per year since 2012, and is predicted to continue at a slightly higher annual rate of 3.0% over the next two years.

• Asia, in contrast, has seen a very strong annual growth rate of 15.3% per year in the proportion of industrial equipment acquired through asset finance, which respondents say will continue – though slightly easing to 14.2% per annum over the next 24 months.

• Demand for manufacturing equipment finance is particularly strong in certain parts of the world:
  • China (nominated by 90% of respondents)
  • Poland/manufacturing Eastern Europe (nominated by 76% of respondents)
  • South East Asia except China (nominated by 76% of respondents)
  • Latin America – especially Mexico and Brazil (nominated by 48% of respondents)
  • Turkey (nominated by 45% of respondents)

• Future growth in the proportion of manufacturing equipment financed with an asset finance package may well be accelerated due to the continuing, more restrained access to traditional credit lines, (as seen in recent years) in particular for small and medium-sized businesses (SMEs).

• 72% of respondents report that their customers have been experiencing a ‘squeeze’ on their capital equipment budgets in the last two years, a further corroboration of the rising demand for financing options to acquire equipment.
Manufacturing Trends

Across the world, the manufacturing industry presents a picture of mixed fortunes. In Europe, the overall picture is now generally more positive. German industry has continued to show steady growth;1 France is on the verge of contraction;2 Spain is growing after years of difficulty;3 and the UK is rising fast after a period of stagnation.4 In Poland, representing the vibrant Eastern European growth phenomenon, manufacturing’s rate of increase is slowing following a huge growth spike in 2013.5 Further East, the Russian manufacturing downturn has eased a little, but is still marginally net negative.6

The giant of the East – China – is showing signs of a manufacturing slowdown after many years of rapid expansion,7 reflecting the actions of the authorities who have been introducing various measures to ensure the economy does not overheat.8 The other major Asian player – India – is, on the other hand continuing to manage steady manufacturing growth, despite last year’s rupee crisis, frequent power cuts, and through the disruption of a national election.9 Straddling Europe and Asia, rapid growth economy Turkey has seen months of positive manufacturing progress, with the occasional pause in development.10

Finally, in the U.S.,11 the world’s largest economy, manufacturing has recently experienced the sharpest rise in production levels since 2011, underlining the country’s economic recovery.

Capital investment, including business investment as a whole is expected to rise (in some countries “to continue rising”) over the next few years. And this may be taken as a broad indicator of the trends in industrial equipment investment. In Western economies, this investment is inspired by improved economic conditions and in part represents the desire and confidence of businesses to upgrade their technology in order to take full advantage of the new wave of growth. In other countries, which have been growing strongly for some time, such as China, Turkey12 and India,13 capital investment is expected to continue – on a more sustainable footing now that mature economies around the world are now largely back into growth mode.

However, business investment – particularly in the capital-intensive manufacturing industries and especially for medium-sized and smaller players – requires efficient financing techniques, often separate from existing lines of traditional credit, to help finance the need for technology acquisition and upgrades.

Acquiring Manufacturing Technology – Sources of Finance

Manufacturing14 is undoubtedly a capital-intensive sector. Outputs rely on expensive, high-specification, tailor-made production equipment. Access to up-to-date equipment is clearly influential on a manufacturing company’s competitive position, cost-control and productivity. However, precisely because of their capital-intensive nature, manufacturing firms are often highly-leveraged, or at least find a good proportion of their precious capital (accumulated cash or traditional borrowing limits) tied up in keeping their underlying technology as efficient, effective and capable as possible. This means less working capital is available for tactical opportunities, such as a marketing and sales drive in response to sudden demand, rapid new product development to meet an emerging market need, or establishing a new presence in foreign markets. In some cases, particular manufacturing sectors have also been subject to historic under-investment. In these instances, equipment upgrades constitute more of a

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1 Markit, Manufacturing PMI, Germany
2 Markit, Manufacturing PMI, France
3 Markit, Manufacturing PMI, Spain
4 Markit, Manufacturing PMI, UK
5 Markit, Manufacturing PMI, Poland
6 HSBC, Russia Manufacturing PMI
7 HSBC, China Manufacturing PMI
8 Asia Sentinel, China: Overheating Despite Slowing Growth?, 21 Feb 2014
9 HSBC, India Manufacturing PMI
10 HSBC, Turkey Manufacturing PMI
11 Markit, Manufacturing PMI, U.S.
12 Wall Street Journal, Turkish growth beats expectations, 10 June 2014
13 The Hindu - Business Line, IMF Bullish on India Growth, 11 June 2014
14 Defined as International Standard Industry Classification (ISIC) Code Section C

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critical structural modernization of the sector as a whole, and financing techniques have a crucial role to play here.

For smaller manufacturing companies (such as suppliers to the automotive industry) – often machine tools users making components for larger manufacturers – this can present a major stumbling block to sustainable business growth. In some countries, the absence of a mature system of business information providers can make it difficult (and therefore expensive) for traditional generalist lenders to streamline the process of credit assessment of a small or medium-sized manufacturing company. The result is often restricted access to credit for this section of the business community; and/or slow credit decision making by lenders, undermining the company’s ability to grasp opportunities; and/or inappropriate, standardized financing packages that do not flex to accommodate the financing period, nor embrace a range financing requirements (equipment, service, maintenance, installation, upgrade, etc), to fit the manufacturing company’s needs.

In all economies, small and medium-sized businesses (SMEs) pay a premium for standard loans compared with larger companies, whose credit profile the lender finds much easier (and economic) to assess. And this can have a substantial impact on the cost of borrowing for SME companies. In the UK, for instance, while the prime lending rate (defined as the average lending rate for high credit rating companies) is around 4% per annum, standard SME loan rates are typically around double this prime rate. In India, for instance, the financing obstacle for SMEs is recognized to the extent that the authorities are trying to mitigate high interest rates for such companies by providing a loan backstop guarantee. The table on the left which shows the prime lending rate in the majority of countries examined in this report illustrates the true cost of borrowing for SMEs when 3-4 percentage points have been added to these rates.

**Asset Finance in the Manufacturing Equipment Market**

So how are manufacturing companies, and particularly SME manufacturers, financing the equipment they need to acquire in order to stay up-to-date and competitive? One key tool is asset finance. Recent research from the European Central Bank, for instance, notes that 17.5% of manufacturing SMEs said they had used asset finance (in the form of leasing) in the last six months. Directly comparable data is not available for China, India, Poland or Turkey, but a previous study from Siemens’ Financial Services Division (SFS) has noted growing demand for asset finance for the acquisition of machine tools globally, providing a level of anecdotal indication that business behavior in emerging markets is likely to be similar to that of European manufacturers. In the U.S., the most mature asset finance market in the world, the Equipment Leasing and Finance Association tells us that 2013 was expected to have seen 55% of manufacturing equipment acquired using an asset finance arrangement.

The role of asset finance techniques such as leasing and renting to unlock liquidity and preserve capital is widely acknowledged. One international bank noted that “The most significant advantage of leasing lies in the fact that it preserves and safeguards liquidity.” The benefits of asset finance and leasing are variously characterized:

- by a technology analyst as “a superlative solution to unlock capital”;
- by an international bank as “an important tool to unlock working capital”;
- by another technology analyst as an “important option to preserve capital”.

The manufacturing media itself recognizes these benefits, with one publication noting that “this approach has unlocked capital for countless smaller manufacturers who

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14 IIFL, Banks to give benefit of differential business rate to MSE, 16 April 2014
15 ECB, The Survey on the Access to Finance of Small and Medium-Sized Enterprises (SAFE)
16 A Silburt, Financing Obstacles for SMEs in China, 1 June 2012
17 Siemens Financial Services, Making the upgrade, November 2013
18 ELFA, Equipment Finance in the Industrial and Manufacturing Technology Industry
19 Credit Suisse, Swiss leasing Market, February 2013
20 Global Industry Analysts, Medical equipment leasing and renting, April 2013
21 Royal Bank of Scotland, Asset finance – an important tool to unlock working capital
22 IDC in Wall Street Journal, Companies opt to lease and finance equipment to preserve capital, 30 July 2012
were turned down for a bank loan. Another key publication noted that “a lease can provide significant benefit in the preservation of working capital and cash flow management.”

Traditional, generalist financiers on the whole tend to lend on a short term, variable basis and will often require additional security or impose credit caps when economic circumstances worsen. In comparison, asset finance arrangements tend to be fixed for the whole period of the agreement, guaranteeing usage of the technology so long as monthly payments are met. This helps to eliminate the volatility of shorter-term economics (interest rates, inflation, and credit conditions) and market dynamics. Following several years of fluctuations in the price of credit, businesses are increasingly attracted by financing methods which secure an alternative, predictable level of monthly payments for the whole financing period.

Such flexible, tailored financing arrangements tend to be offered by technologist-manufacturing financiers: They understand technology development paths and their application in business, they also have a deep knowledge of asset management and understand collateral values, all of which enables them to take expert decisions and craft tailored financing packages that generalist financiers tend not to offer. As with other areas of the financial services market, such specialist providers use their expertise to make financing decisions, and to offer quality and speed of service, based on their in-depth knowledge of markets, assets (equipment), and those assets likely contribution to the business.

The next section of this paper presents new evidence of recent trends in the use of asset finance by manufacturing companies in three regions of the world, along with predictions of future uptake.

Research– Use of Asset Finance for Manufacturing Equipment Grows

In order to gauge recent and future take-up of asset finance for the acquisition of industrial equipment, SFS commissioned independent research, conducted among the top 40 global machinery and equipment manufacturers. The research canvassed opinion from these respondents about their customers’ recent experience in terms of global asset finance demand. The study also explored views on future demand across three key regions of the world: Asia, Europe and the U.S.

On a global scale, asset finance has evidently been growing in popularity, with 76% of respondents seeing a greater interest from their customers in using asset finance to acquire their manufacturing equipment. Different regions of the world, however, make the underlying picture more heterogeneous. European customers have been static in their use of asset finance over the last two years, presenting no change in the proportion of their annual European sales acquired through a financing package. In contrast, the proportion of manufacturing equipment sales enabled through asset finance has risen 2.1% per year in the U.S. in the last two years, and an astonishing 15.3% per year in Asia. It should be noted that asset finance may be rapidly growing in Asia, but is still in a relatively early stage of its development compared with the mature economies of the West.

Manufacturing companies have certainly been feeling under pressure. 72% of respondents report that their customers have been experiencing a ‘squeeze’ on their capital equipment budgets in the last 2 years, a further corroboration of the rising demand for financing options to acquire equipment.

Looking to the near future, 93% of respondents expect increased interest from their customers globally in using asset finance to acquire their equipment over the next two years. This picture varies by region. In Europe, where manufacturers have probably been deferring investments until business economic confidence returns, the

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25 Canadian Manufacturing, Tips for buying and leasing, 18 July 2013
26 Food Manufacturing, Lease vs. buy, 13 September 2013
proportion of manufacturing equipment sales enabled through asset finance is expected to grow by 5.1% per year over the next two years. This probably reflects a formerly suppressed need to invest which is now being released because of new found confidence in the improved economic climate. The expected growth rate in the U.S. is apparently lower at 3.0%, but this should be viewed in the light of the U.S. being a market with very significantly higher penetration of asset finance than Europe. Therefore, this lower percentage growth nevertheless represents proportionately larger absolute volumes relative to size of economy.

In Asia, extremely strong growth in the proportion of manufacturing equipment sales funded through asset finance is expected, increasing by 14.2% per year over the same period. It is relevant to note that, as well as the rapid development of leasing companies in China, the authorities have been encouraging foreign private capital to participate in the market for some time.27

Respondents were also asked to highlight which parts of the world were likely to experience particularly strong growth in the proportion of annual sales enabled through asset finance over the next two years. While China, unsurprisingly topped the chart, this question elicited other interesting trends.

Machinery and equipment companies identify Poland and Eastern Europe28 as showing particularly strong increases in the use of asset finance to acquire essential new and upgraded equipment. Turkey is also growing strongly in this regard, but to a lesser degree than China and Eastern Europe.

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27 Bloomberg, China Encourages Private Investment in Banking Sector, 26 May 2012
28 Eastern European countries that have a particularly heavy concentration of manufacturing
Conclusion

Although some regions of the world, notably Europe, have seen no increase in the proportion manufacturing equipment acquired using asset finance over the last two years, the pent-up desire to invest in more productive (and often more energy-efficient) equipment is predicted to grow strongly over the next two years.

In the U.S. steady progress is being made on this front, and in Asia high rates of growth in the use of asset finance are expected, although this must be interpreted as building on a much lower base than in the more mature markets of the West.

Stand-out areas of the world for strong growth in industrial equipment asset finance include some unexpected performers, notably Poland and Industrial Eastern Europe.

Even as liquidity returns to the financial services sector, it appears that asset finance is set to continue to make gains in popularity for manufacturing equipment finance. This is probably because it provides a source of finance that is separate and distinct from traditional borrowing, preserving those lines of credit for tactical business requirements.

Moreover, asset finance is increasingly available from specialist financiers with a deep expertise in manufacturing technologies. These specialist financiers use their in-depth knowledge of markets, technologies and how those technologies can be applied, to create flexible financing packages for manufacturing companies that are not usually available from generalist financiers.

Methodology

Research was conducted among the global top 40 industrial machinery and equipment manufacturers (by turnover) by telephone between May and June 2014. Respondent organizations gave their experience and views on the current and predicted use of asset finance by their customers in equipment acquisition. Respondents described these trends split by region of the world, and also identified regions or countries exhibiting particularly strong growth in the use of asset finance to acquire industrial equipment.