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# 5

BEST PRACTICES  
FOR MANAGING

**LEASED EQUIPMENT  
SPEND IN MANUFACTURING**

BY BOB SOLOMON



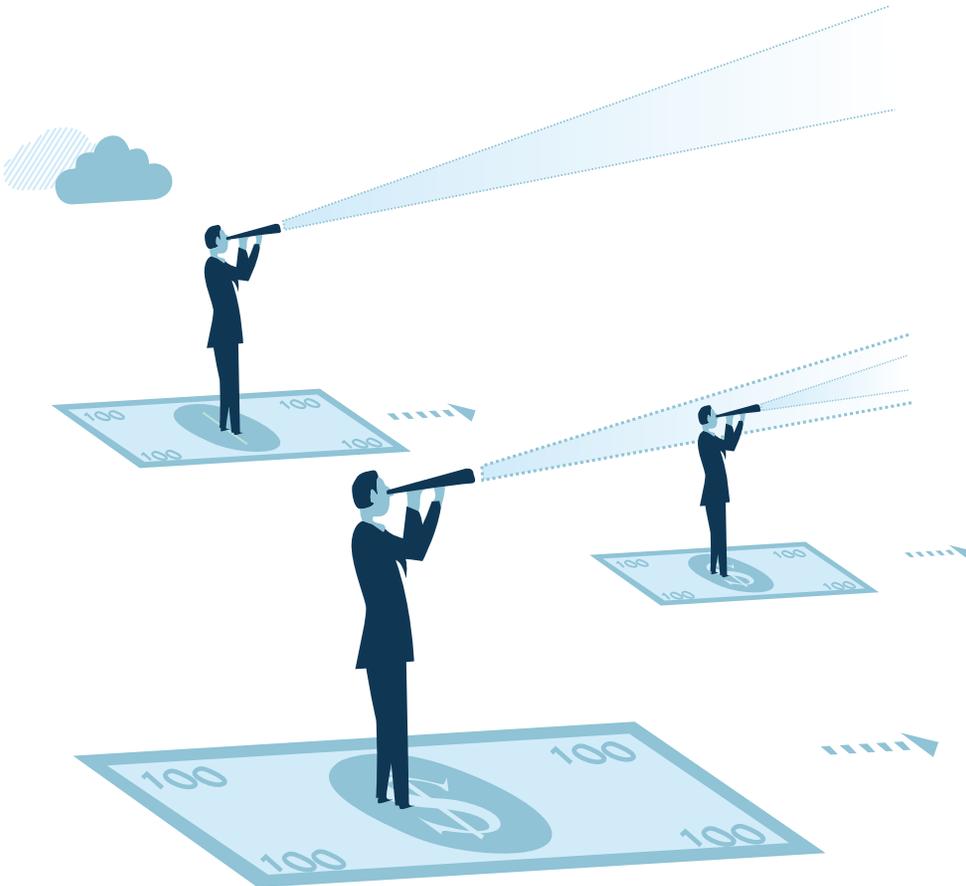
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# The Leased Equipment Spend Category

American businesses, nonprofits and government agencies invest almost \$1.5 trillion in plant, equipment and software annually. Seventy-two percent of U.S. companies use some form of financing when acquiring equipment, including loans, leases and lines of credit (excluding credit cards). Leased equipment is a huge category growing at 8-10% annually, reflecting an economic recovery and attractive borrowing rates.

## Huge, Growing, and Diverse

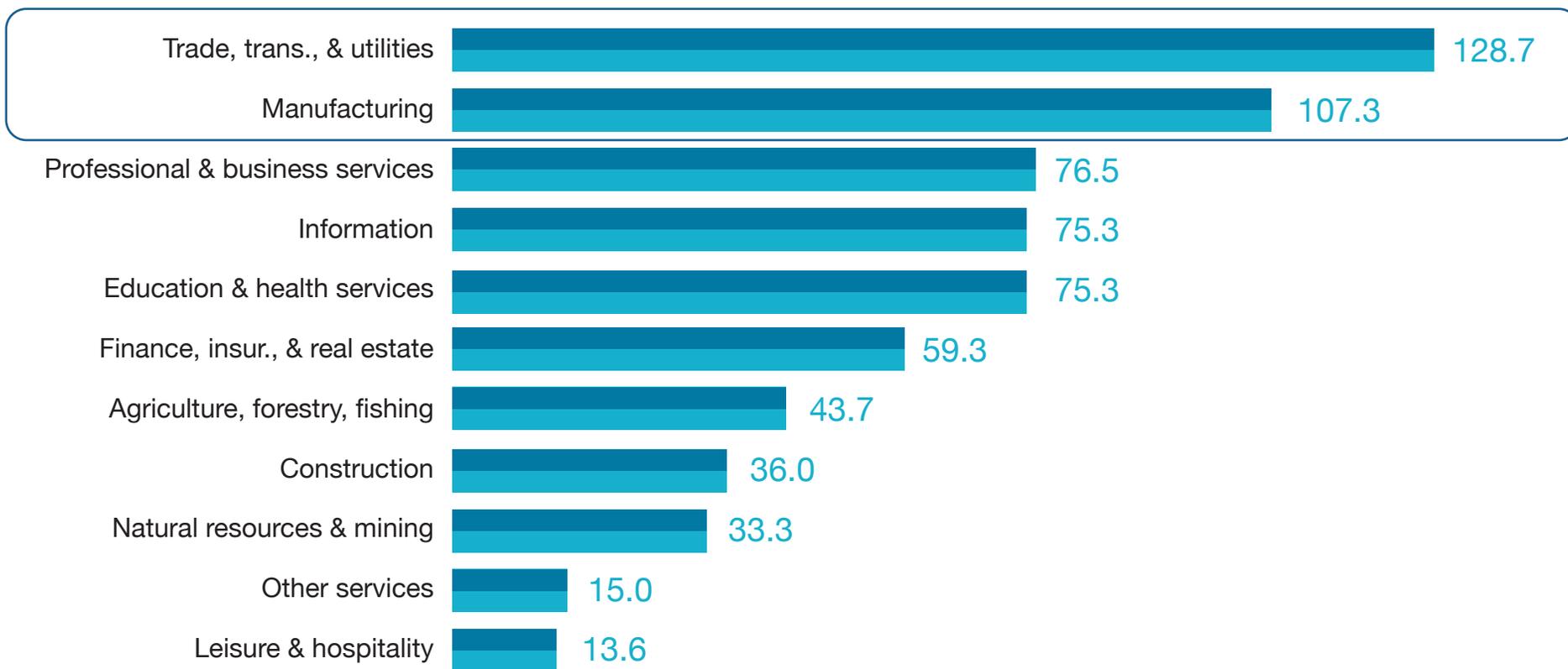


The two industries with the greatest leased equipment spend are, not surprisingly, transportation and manufacturing. Each spend more than \$100 billion on leased equipment annually.



Fortune 500 manufacturing and transportation companies commonly have equipment lease spend of \$100 million or more. Some spend up to \$500 million annually. Despite its size and ubiquity, leased equipment spend is still a poorly managed spend category in most manufacturing companies. This is true for five primary reasons.

## U.S. Equipment Finance by End-User Industry in 2011, \$Billions



Source:IHS

Five Reasons Why  
**Equipment Leasing is a Poorly  
Managed Spend Category**



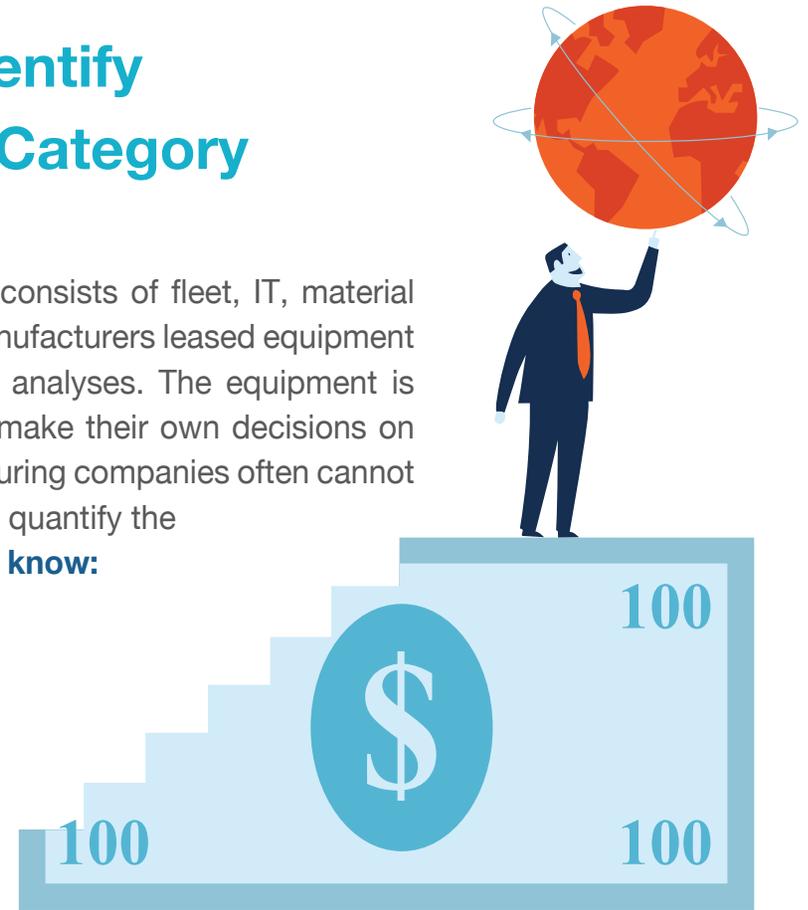
# 1

## Many Manufacturers Do Not Identify Leased Equipment as a Spend Category

Capital equipment in an industrial manufacturing company consists of fleet, IT, material handling, lab, office equipment and much more. For many manufacturers leased equipment is not defined as a category or included in sourcing wave analyses. The equipment is typically purchased by different category owners who may make their own decisions on leasing versus buying. As with all spend categories, manufacturing companies often cannot readily identify the size of the leased equipment problem and quantify the benefits of solving it. **Many Fortune 500 companies do not know:**

- How much equipment they are leasing
- The terms associated with those leases
- Who is providing the financing for those leases
- When those leases will come up for renewal

The status quo of lost savings opportunities goes on and on.



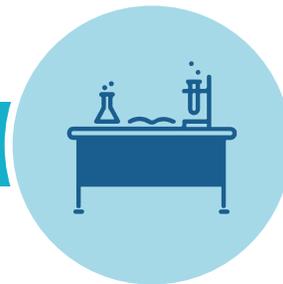
### Traditional approach – spend categories managed separately



Fleet



Material handling



Lab equipment



Office equipment

# 2

## Failure to Unbundle Purchase & Finance

Most manufacturing companies source their capital equipment fairly well. But most also fail to engage strategic sourcing professionals and their best practices on the financing, or lease, portion of the transaction. Financing is a completely distinct procurement—or should be. Unbundling these two “buys” is a classic strategy that is too often overlooked.

Bundling the original buy together with the lease is akin to negotiating carefully on the purchase price of a new car and then capitulating on the most expensive dealer warranty without shopping around. We have all done it and, in fact, dealers count on us to! That does not make it right — especially when the purchases are in the hundred of millions of dollars.

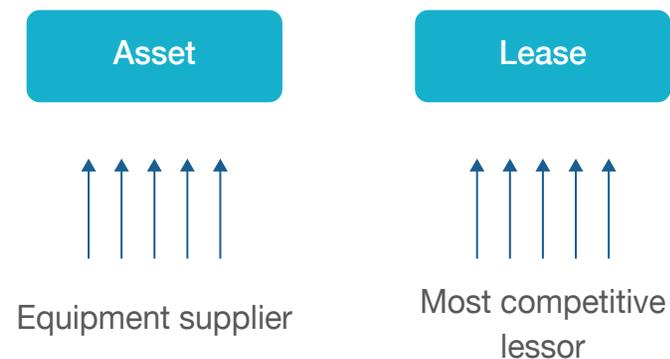
This supply market can, and should, be brought to bear by your sourcing and procurement professionals - if you will let them!



### Traditional bundled approach



### Optimized unbundled approach



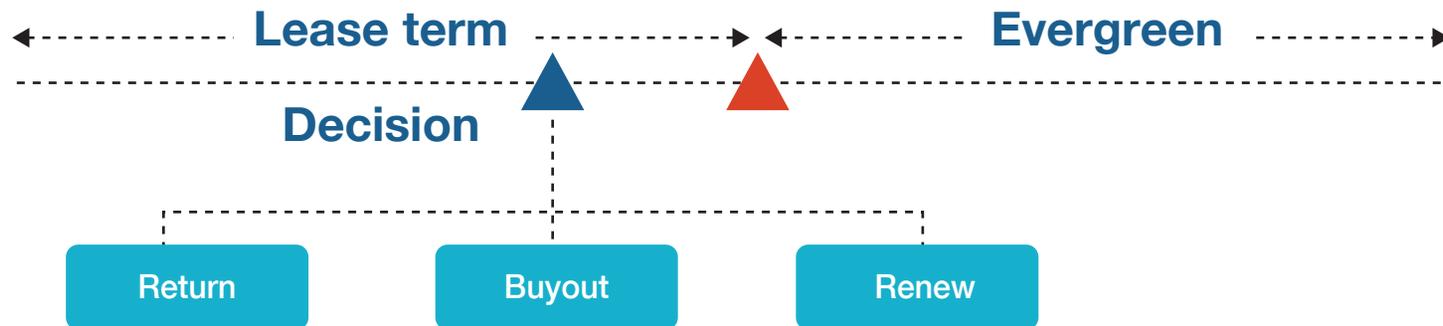
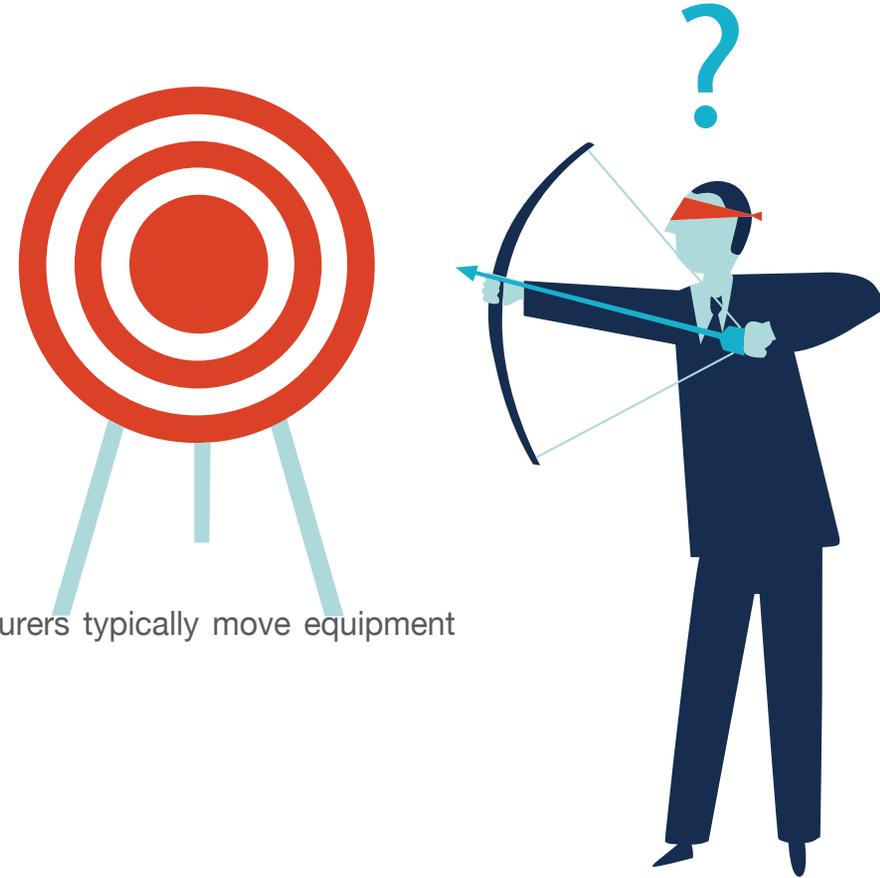
# 3

## Poor Management of Leased Equipment Lifecycle

In procurement terms, leases are multi-year contracts with a very important financial decision at the end of the term. When the lease is over, the lessee must decide whether to return, renew, refresh or buy the equipment.

Failure to track equipment properly and proactively manage the end of term decision is the most common and costly error made in this spend category. Lessors know this and count on this. There are many four year leases out there on their seventh year...even a few in their 14th year!

Large manufacturing companies are the most common victims of end of term “spend leakage.” Global manufacturers typically move equipment between plants and divisions to maximize its utilization.



# 4

## Lack of Process Automation and Visibility into Leased Equipment Portfolio

Buying equipment outright is straightforward. A purchase lowers transaction costs (“one and done”) and accounting complexity. But manufacturers then are out all of the cash and have the equipment on their books. Leasing has financial and accounting benefits, but it is also a more complex transaction. Trying to manage a lease portfolio of any reasonable size with spreadsheets, e-mails, and paper contracts is a recipe for disaster. The result will be inconsistent buy versus lease decisions; accounting compliance risk; and a really unhappy CFO.

You cannot manage what you cannot see. And often you cannot see what you have not automated. Unmanaged leases mean not only lost savings, but real accounting risk. Smart manufacturers are automating leased equipment, so they can make the right financial decision and reduce risk.



### Eliminate



Emails



Spreadsheets



File cabinets



Post it notes

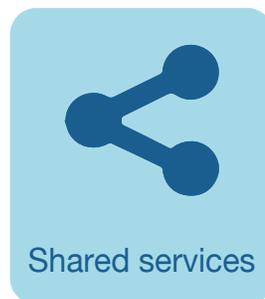
# 5

## Lack of Ownership and Accountability for Leased Equipment Spend

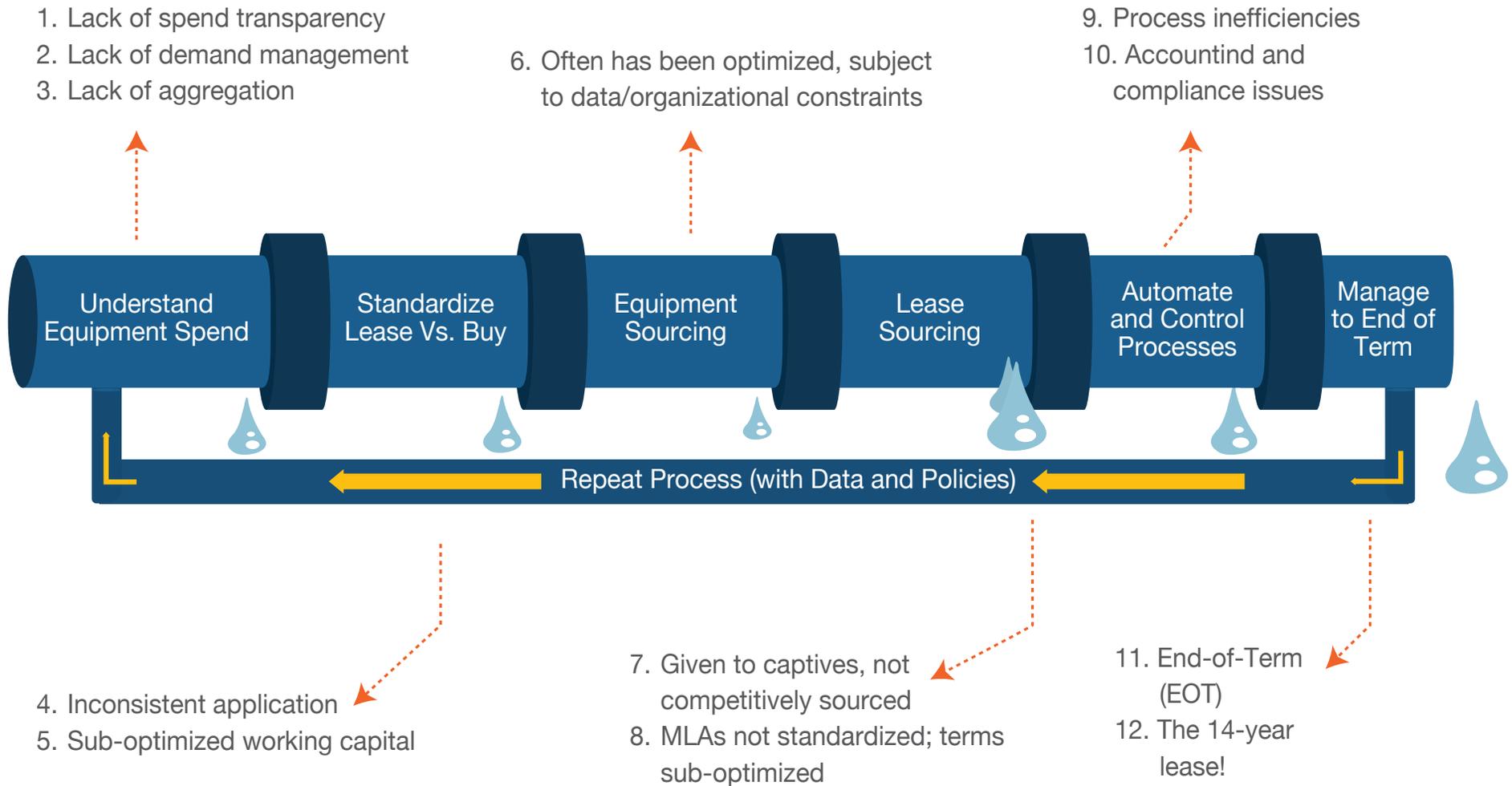
Have you ever driven hard dollar savings to the bottom line of a spend category that no one owned? (That's a rhetorical question). CPOs are increasingly taking ownership for equipment leasing as a category or at least dedicating a specialist to help capital equipment buyers manage the sourcing and contracting of leases. Cross functional teams are being formed with Treasury, IT and other groups to attack this category from Source to End of Term (i.e. the sunset of a lease).

Leased Equipment Spend is akin to water flowing through a pipe. Right now, most organizations have a lot of leaks in the pipe that mean lost savings, excessive processing expense, and excessive accounting and compliance risk.

### Who Owns Leasing?

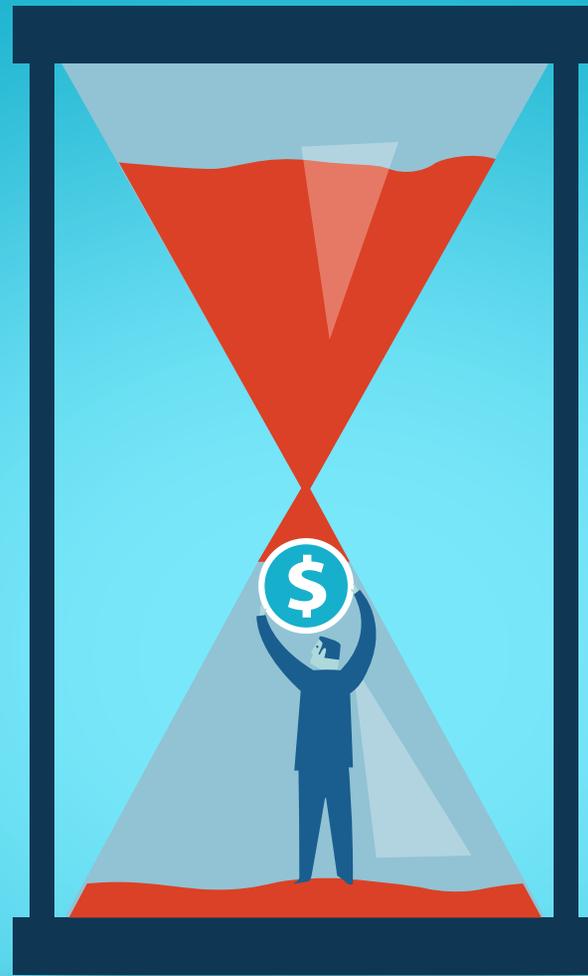


# Value Leakage in Leased Equipment Management



Forward-thinking manufacturers are making people, process and technology changes to address these leaks, drive savings, and reduce risk. How these manufacturers accomplish these goals is the subject of our next section.

Five Best Practices in  
**Leased Equipment  
Spend Management (LESM)**



# 1

## Analyze, Aggregate and Centralize Spend

This best practice is no surprise to procurement professionals. After all, it's the start of every spend category's strategic sourcing process! Spend analysis is especially important in equipment leasing because the spend is so diffuse by department, by equipment type, by lessor, and lease type.

Once the spend is well characterized, best-in-class companies find opportunities to aggregate spend at two levels. First, spend can be aggregated for the underlying capital equipment purchases to improved sourcing of initial prices. Second, spend can be aggregated across the portfolio of leases. Lessors, like equipment vendors, prefer larger financing deals given the relatively fixed cost of terms negotiation and transaction processing.



### HUNDREDS OF LESSORS

Networking  
equipment leases

Computer  
equipment leases

Software  
license leases

Lab equipment  
leases

Industrial  
equipment leases

Furniture  
leases

Fleet/Vehicle  
leases

Container/Railcar  
leases

### A FEW LESSORS

Multi-category  
portfolio of  
leases



# 1

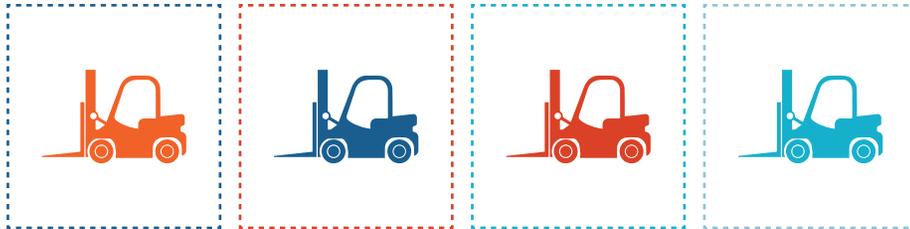
## Case Study #1

### Analyzing, Aggregating and Centralizing Spend

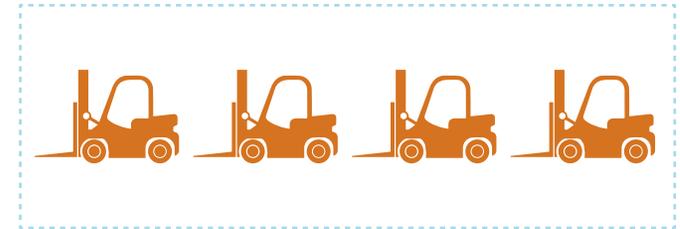
A Fortune 500 industrial manufacturer deployed an Equipment Lease Management (LeaseAccelerator) application to analyze, aggregate and centralize spend. First, the client's Finance and Accounting team built an integrated lease and asset database. The company originally thought they had 2200 leases, but discovered a total of 7400 leases from 44 countries. Nearly 1000 leases had to be translated to English first! The database was integrated to the client's Oracle ERP and Ariba procurement systems to ensure complete automation of the process.

For procurement, the process yielded the insight to aggregate and consolidate material handling leases from numerous vendors into one large, competitively bid event. The increased size of the transaction attracted more Lessor interest. Savings on just this one group of equipment leases yielded almost \$700,000, or about 7% of spend.

#### Many independent leases for material handling equipment

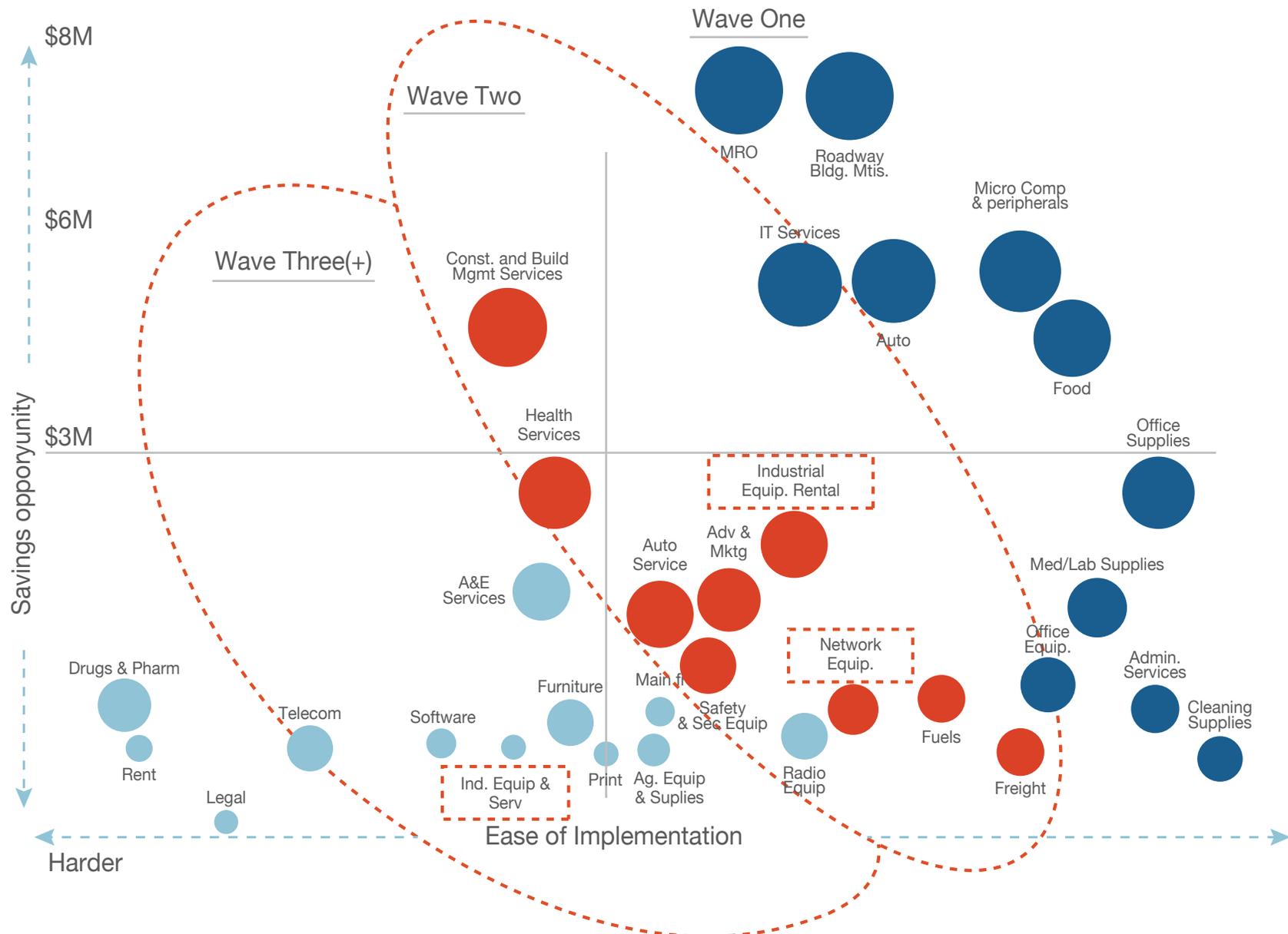


#### Aggregated lease for material handling equipment



For most companies, leasing has historically not been a focus for spend management. It may not even be in the strategic sourcing wave analysis. By applying a spend management approach to leasing as category procurement organizations can understand the total spend and calculate the expected savings.

# Spend Analysis – Sourcing Wave Plan



Source:Accenture

# 2

## Standardizing the Lease Versus Buy Analysis

Many manufacturers with large capital equipment budgets have implemented solid demand management programs. Typically, Capital Asset Request Forms and other procedures must be submitted to justify large equipment expenditures. Far fewer companies, however, have a standardized “lease versus buy” decision tool, which should be a part of any equipment sourcing strategy.

A proper lease versus buy analysis tool uses as a foundation Treasurer-provided assumptions on the company’s cost of capital. It forces budget owners to weigh the hard and soft costs of both options.

A solid lease versus buy analysis leads to the optimal use of corporate capital. Using automated workflow, this type of tool provides a visible funnel through which accounting, treasury, and procurement can see equipment lease demand before decisions are made.



# 2

## Case Study #2

### Standardizing Lease versus Buy

For one global industrial manufacturer, the decision to “lease or buy” is made by thousands of budget holders in over 100 countries around the world. Treasury designed a spreadsheet based tool to help guide the lease versus buy decision. For each lease the financing terms need to be assessed and an indicative ASC 840 (aka FAS 13) test needed to be performed.

Many buyers used an older version of the spreadsheet stored on their local hard drive. Treasury’s spreadsheet was complex and hard to use. The key financial variables such as Internal Borrowing Rate, Cost of Debt and Weighted Average Cost of Capital were quickly out-of-date if the buyer was not using the latest version.

A centralized team in Treasury would review the local buyer’s lease versus buy spreadsheets, but only if the buyers in the field sent them. If the buyer did not email Treasury the spreadsheet to review, Treasury had no idea who in the company around the world was contemplating a lease, nor if the financial variables were accurate. As a result, Treasury missed the opportunity to eyeball a large percentage of the lease volume. You can’t track what you can’t see.

To gain control of the lease versus buy decision the company decided to standardize on a global process based upon Six Sigma principles. A best-in-class Equipment Lease Management application (LeaseAccelerator) was deployed which offered a standardized lease versus buy tool. Users enter leasing needs directly into a web-based application or use a downloadable Asset Request Form (ARF). For each Lease versus Buy analysis a seven-page report is produced complete with summary recommendations, cash-flows and tax analysis. The process ensures accurate, just-in-time analysis in the field with centralized control and visibility. Treasury only has to manage the exceptions -- the remainder of the process is automated. Since inception of the project, the company has processed almost 8,000 ARFs in 40 countries.

Treasury estimated that 3% of their Capital Expenditures (CapEx) had inaccurate lease versus buy analysis being performed. The cost of to the company was estimated to be 2% of total CapEx. The new process resulted in a dramatic 200% increase in the number of ARFs submitted and LvBs generated. By automating the process for all stakeholders, Treasury estimated that they saved three hours per LvB across the company. All told, Treasury saved \$675,000 or more each year.



# 3

## Leverage Competition by Unbundling Financing from Equipment Purchases

The supply market of lessors is distinct from the supply market for equipment. It is all too easy just to accept lease terms provided by the “captive” finance arm of the equipment manufacturer. But these captives, independents, and banks will readily finance multi-vendor packages and also prefer larger transactions.

Best practice is to unbundle the financing decision from the purchase decision. Buyers should bid the lease competitively in the global market of providers. In a fair market value (FMV) lease, savings is driven not only by a lower interest rate but also a larger equity investment by the lessor. The easiest way to measure the savings is by comparing the Present Value (PV) of the lease payments of all the bids. As with most competitive sourcing techniques, even a simple sealed bid technique can yield consistent savings of 7-12%. These are highly quantifiable, hard-cost negotiated savings that you can take to your CFO.



**Competitive sourcing of lease terms can yield consistent savings of 7-12%**

# 3

## Case Study #3

### Unbundling Financing from Equipment Purchases

Eaton Corporation saved \$2.2 million on just \$12 million in leasing volume by competing its leases on an electronic marketplace. With the marketplace all of the lease terms were standardized in a manner mutually acceptable to both lessor and lessee. The standardization allows lessees to leverage competition, but also removes costs for the lessors, so they are willing to compete. It's about changing the lease supply chain process and removing costs from the transaction from both parties, not about "beating up" lessors.



# 4

## Control Lease Process and Compliance Costs

Leasing means entering into contracts with recurring transactions, important end-of-term decisions, and significant accounting treatment implications. These realities drive the need for process automation.

If you remember your Accounting 101 class, you probably still have nightmares about FASB 13 (now called ASC 840) which governs the rules around Capital versus Operating leases. ASC 840 determines whether the lease belongs on the balance sheet or in the footnotes. But the reporting complexities are only part of the challenge. Many of these assets can and should move around the company during their lease-life, physically or logically, making the cost allocation process challenging.

Internal and external auditors want to check that manufacturers are accounting for these leases properly. Best in class manufacturers realize that to properly track assets, allocate costs and apply ASC 840 tests, they need a system to:

- Track equipment from cradle to grave;
- Automate lease, invoice and payment transactions;
- Integrate as a lease accounting sub-ledger to their ERP platform.

The application becomes the auditable “system of record” for all of a company’s leased equipment. With an automated, centralized system, and straight-through processing (STP) all relevant stakeholders have visibility to the lease portfolio. Users trust the data quality and can collaborate through customized workflow. Monthly and quarterly closes and reconciliation become quick and painless.



# 4

## Case Study #4

### Process and Controls for Leasing

A cloud computing provider discovered it had a material weakness caused by a lack of controls in the equipment leasing process. The company had relied on spreadsheets to track leases. When auditors discovered the accounting issues, the cloud provider decided to move off of spreadsheets fast to a true Equipment Lease Management (ELM) application (LeaseAccelerator).

The project was led by the CFO and VP of Corporate Accounting. The company selected a vendor and deployed the software in two weeks. After a brief effort to upload their leasing data and documents the cloud provider became immediately compliant with GAAP and ASC 840.

The application featured a lease accounting sub-ledger that integrated directly with their Oracle ERP application. More importantly, the new ELM application could easily be integrated with their home-grown data-center centric asset management system.

According to shareholder-advisory firm Glass, Lewis & Co, revelations of a material weakness related to lease accounting issues results in a drop in share price of 0.86% after 60 days. In this case, reduced errors from the deployment of an Equipment Lease Management application enabled the company to avoid a 0.86% reduction in its approximately \$40 billion market capitalization or \$344 million in potential shareholder losses.



**“Revelations of a material weakness related to lease accounting issues results in a drop in share price of 0.86% after 60 days.”**

# Straight-through processing: integrated End-to-End

## Procurement system



Purchase request  
Purchase order  
Cost center  
Governance

PO data

lease  
accelerator



Journal entries  
Amounts due  
& allocations

## ERP System(s)



Corporate hierarchy  
G/L Coding  
Cash disbursement info

Upgrades, Moves, Adds, Changes  
EOT secision: Return, Renew, Buyout

ELM



## AssetManagement System

Origination  
data & docs

MACs &  
EOT data



Lessors'  
Accounting  
Systems

Payment  
Invoice

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# 5

## Turn Negotiated Savings into Realized Savings with End of Term Management

At the end of term, lessees must decide if they want to renew, buyout, and/or return the leased equipment. The decision typically must be made at least 60 days before the lease ends so the lessor can be notified pursuant to the contract terms. All too often this process happens inconsistently, late, or not at all. A lack of action at end-of-term, as with many contracts, can result in an “evergreen” lease. It becomes a lessor’s delight, but a lessee’s nightmare!



### Best in class companies:

- Track assets throughout their lifecycle to end of term
- Notify current asset owners prior to the end of term with adequate time for analysis
- Add workflow for other stakeholders such as procurement and treasury
- Provide guidelines for making the end of term decision

Companies with best practices return equipment on time to the lessor. In the case of a Fair Market Value (FMV) lease returning on time effectively outsources the monetization of the equipment’s residual value to experts in each asset class. Do you know any large companies that aspire to be good at monetizing the residual value of equipment end of life? Not me. Yet another reason why companies lease.

This “leak in the spend pipe” is easily plugged with a Equipment Lease Management system. Without a centralized system and automated workflow, employee memory and training are your only alternative strategies.

**In the case of a Fair Market Value (FMV) lease returning on time effectively outsources the monetization of the equipment’s residual value to experts in each asset class.**

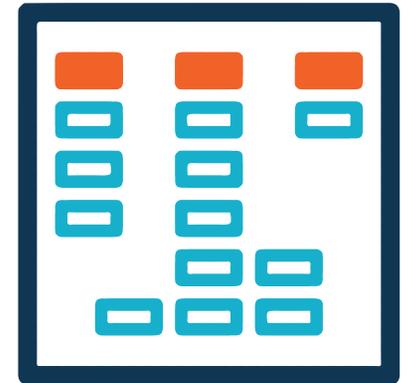
# 5

## Case Study #5 End of Term Management

An industrial manufacturer captured and abstracted 7400 leases from 44 countries to create a centralized lease and asset database. The company then identified all the leases exceeding their original term. The evergreen leases were triaged with the largest and oldest leases being eliminated first. Through returns and buyouts, the company pruned the total active leases down to approximately 3500 leases.

The company can track asset-level changes in location or cost centers over the term of the lease. Stakeholders are proactively notified about end-of-term events so they can make educated decisions on buyouts, renewals and returns. Each stakeholder's performance can be tracked with scorecards illustrating the positive or negative savings generated from their lease portfolio.

Evergreen payments as a percentage of total annual payments (excluding termination fees) dropped from 18% at program inception to an average of 8.5% in subsequent years. The "unplanned/unintended" portion of spend dropped by more than half.



# Summary

To sourcing and procurement professionals, these five best practices for managing leased equipment spend are nothing new. They are commonly applied to many other spend categories with unique requirements in the source-to-settle-to-sunset process. However, the application to the leased equipment spend category that is rather new.

## The keys to success are:

- Identifying leased equipment as a category worth tackling in the first place
- Building a cross-functional team of stakeholders to tackle the process from source to end of term,
- Deploying the software platform to ensure the resulting process can be automated, controlled, and standardized

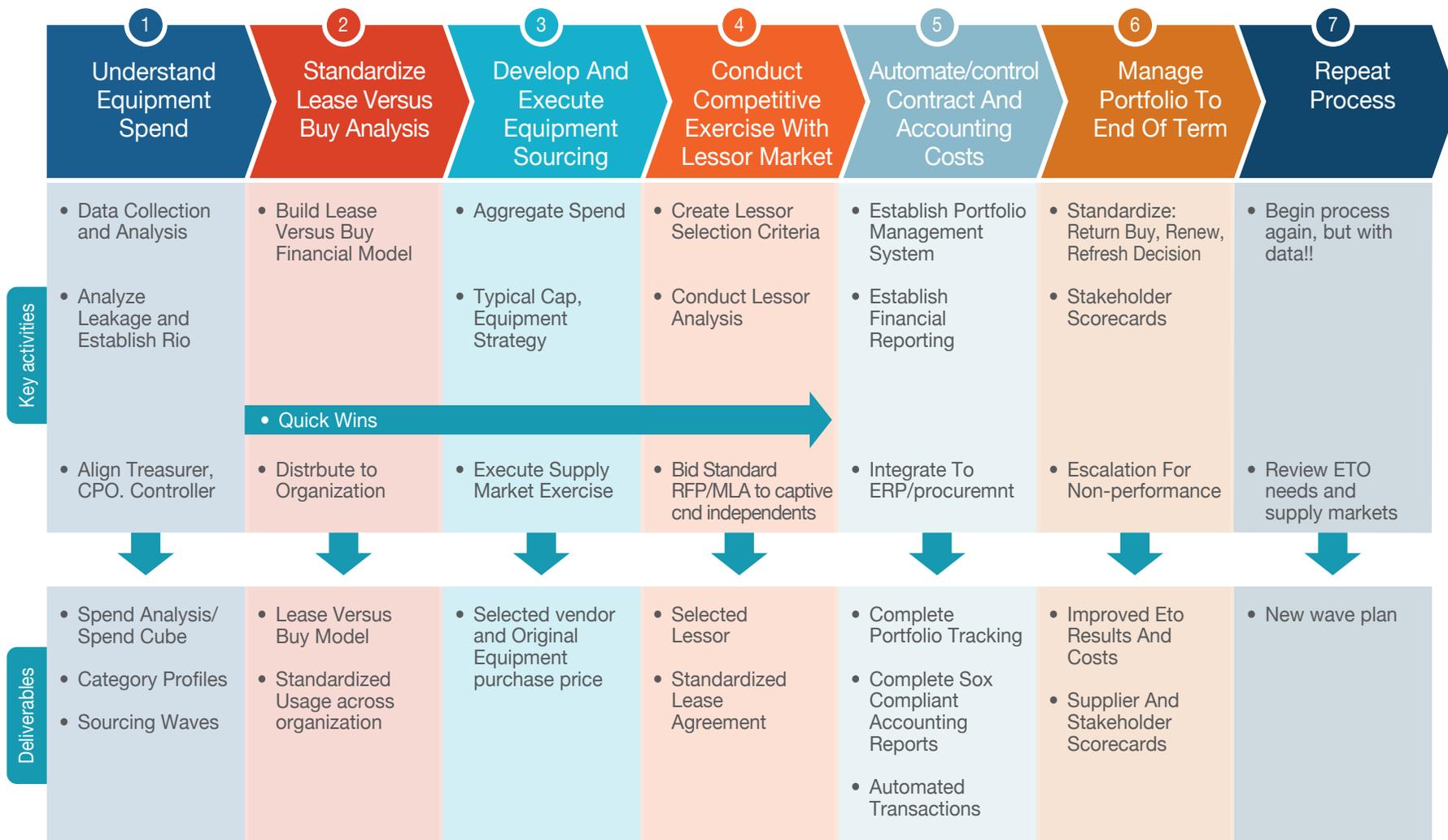
Best practices #3 (Unbundling Equipment Purchases from Financing) and #5 (End of Term Management) drive the largest hard-dollar savings. As a result, these two programs are often the starting point for manufacturers seeking to justify investment in an Equipment Lease Management program.

Sourcing and procurement professionals should think of Equipment Lease Management applications as a specialized “Source to Sunset” solution. The approach is similar to practices adopted in other unique spend categories: T&E (e.g., Concur), Temporary Labor (e.g., Fieldglass), Legal spend (many vendors), or catalog buying (e.g., Ariba).



The best practices outlined for managing leased equipment spend can be summarized in a traditional Seven-Step Strategic Sourcing process.

## Seven Step Strategic Sourcing Process (Applied to Equipment Lease Management)



Source: AT Kearney

## About the Author



**Bob Solomon**

Bob Solomon is the principal of Software Platform Consulting, Inc. (SPCI). Bob helps clients develop successful networks and platforms.

Prior to founding SPCI, Bob was President of ServiceChannel, a SaaS platform in the facilities management industry. Preceding ServiceChannel, Bob was Senior Vice President, Network and Financial Solutions for Ariba, Inc. (now SAP). Reporting to Ariba's CEO, Bob was responsible for monetization of the Ariba Network. Before his 10 years with Ariba, Bob spent 14 years working in the food industry supply chain. Bob began his career in the Chicago office of the The Boston Consulting Group. Bob serves as Lead Director of Ariel Investments, on the boards of Hubwoo SA (NYSE Euronext: HBW) Eved, LLC., and LeaseAccelerator.

Bob received his AB in Economics from Princeton University. He received his MBA from Stanford's Graduate School of Business.

# About LeaseAccelerator

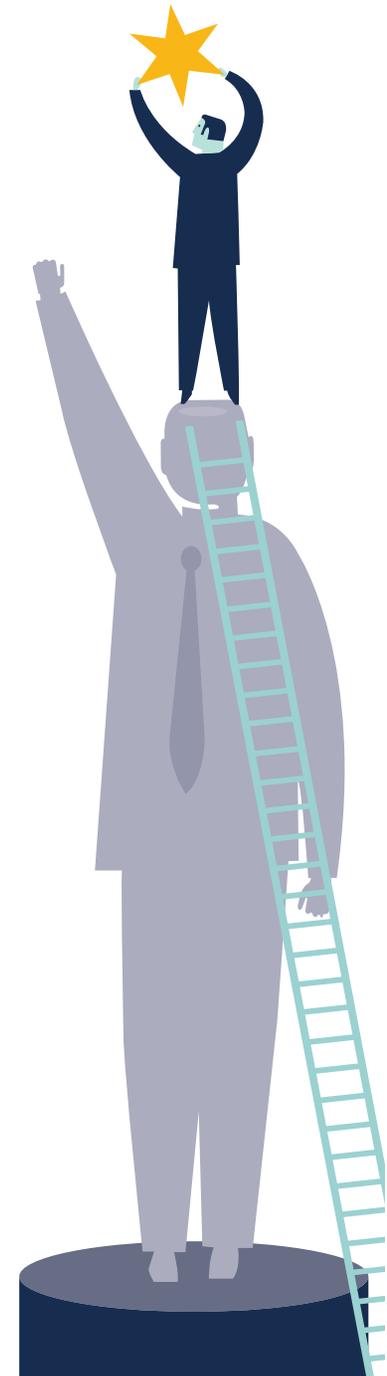
LeaseAccelerator is the market leader in lease management and accounting software (SaaS) designed specifically for equipment lessees. It defines best practices and is used by global companies – including large manufacturers and health-care companies such as Cisco, Cummins, Eaton, Ascension Health, and NetApp – to compete, manage, control, and account for their equipment leases in more than 50 countries, generating recurring hard-cost savings of 12-18% by driving down lease rates and improving return performance.

Using LeaseAccelerator, lessees can manage the lifecycle of leases, assets, stakeholders, and lessors. It enables decentralized work and controls with centralized data, documents, and reporting – supporting lease vs. buy analysis, in-country lease bidding, performance management, portfolio management, accounting, and financial reporting. LeaseAccelerator integrates with procurement systems (iProcurement, Ariba) and ERP applications (Oracle, Peoplesoft, and SAP) and serves as a lease accounting subledger. In addition, it's wrapped by a SOC 1 Type II attestation.

Using LeaseAccelerator, you can control your processes of sourcing capital and booking transactions. Then, over the term, you can manage any asset-level changes in location or business coding. You can also manage any mid-term or end-of-term events (buyouts, renewals, and returns) using notification and attestation capabilities.

These capabilities make it easy to reconcile your portfolio step-by-step at the asset level on a monthly basis and produce auditable financial statements with data that you trust – under the current lease accounting standard or the new one. By adopting LeaseAccelerator, you can remove the uncertainty of transitioning to the new lease accounting standard and continue to use equipment leasing as a strategic tool for your businesses – an objective shared by your lessors.

To learn more visit [www.leaseaccelerator.com](http://www.leaseaccelerator.com)



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lease  
accelerator<sup>TM</sup>

The logo for 'lease accelerator' features the word 'lease' in a serif font above the word 'accelerator' in a bold sans-serif font. A vertical bar separates the two words. Below 'accelerator' is a trademark symbol (TM) and a series of four horizontal lines of varying lengths that extend to the right.

[www.leaseaccelerator.com](http://www.leaseaccelerator.com)