CUMMINS

IMPLEMENTING A BEST-IN-CLASS GLOBAL EQUIPMENT LEASING PROGRAM

Cummins Inc. is a global power leader that designs, manufactures, distributes, and services diesel and natural gas engines as well as related technologies. The company supplies the horsepower to PACCAR, Volvo Trucks, Daimler Trucks, Ford, and MAN in North America.

In 2010, Cummins was emerging from the recession with a relentless focus on growth and profitability. At the same time, the company's finance executives were also methodically improving their processes in pursuit of operational excellence and financial reporting compliance.

FACTS ABOUT CUMMINS

190
COUNTRIES

54,000
EMPLOYEES

US$19.2
BILLION IN REVENUE

#168
ON FORTUNE 500

EQUIPMENT LEASING

Cummins leases a wide range of different types of equipment, including:

- AIRCRAFT
- TRUCKS
- AUTOS & VANS
- COMPUTERS
- MATERIAL HANDLING EQUIPMENT
- LABORATORY & TEST EQUIPMENT
- INDUSTRIAL & MANUFACTURING EQUIPMENT
- NETWORKING GEAR

CHALLENGES WITH EQUIPMENT LEASING

The company did not have a single source of truth for their equipment leasing portfolio. On top of this, the company had a complex and fragmented enterprise software environment that did not support equipment leasing. Ariba was used for Procurement, Oracle for financial reporting, and several other ERP platforms for various other business functions. It was clear that manual data manipulation between the major systems would be required.

At the time, Cummins was using Microsoft Excel spreadsheets and a defunct software product to manage leases. The company lacked visibility into their global leasing portfolio. Leasing was an orphaned process, cutting across several departments and global in scope but without a real owner.

Equipment leasing at Cummins was also highly decentralised. Local budget owners had to decide whether to lease or buy. Although Treasury had built a lease vs. buy spreadsheet, it was neither used consistently nor were the rates updated frequently: stakeholders continued to make poor economic decisions. Furthermore, the company could not measure the economic performance of the portfolio

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LOSING MONEY TWO WAYS

Cummins was losing money in two ways. First, too much was being paid for lease capital on the front end. Second, far more expenses than originally planned were being incurred on each lease when they expired.
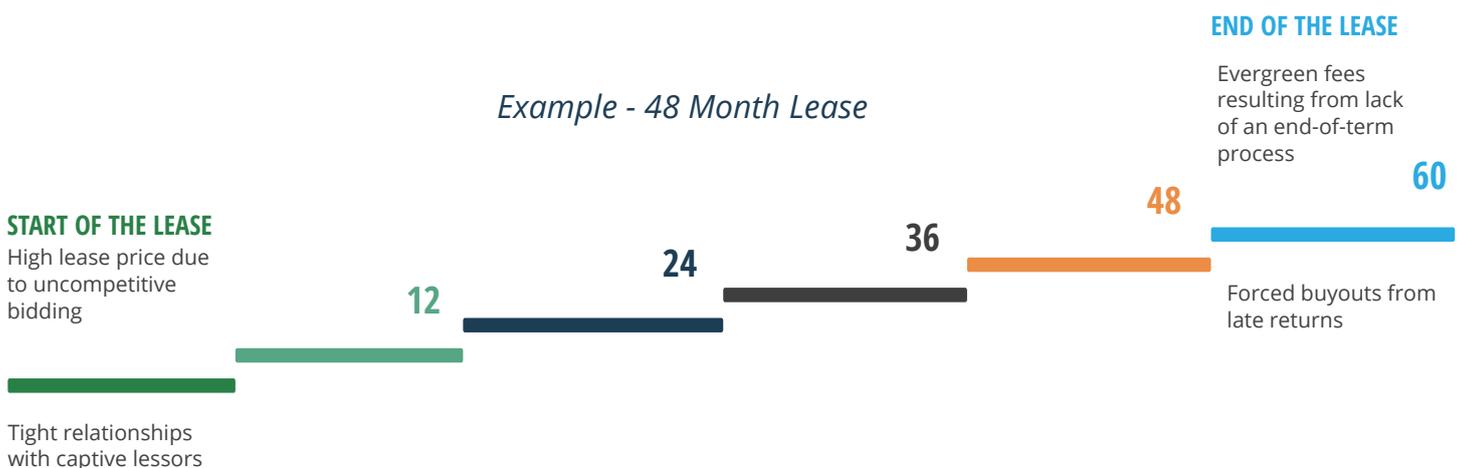
Although Procurement had a mature process for comparing equipment vendors to secure a competitive price, insufficient bidding ultimately drove costs back up. The company's relationships with captive lessors were too tight, making a truly competitive lease quote difficult.

Cummins also was making many evergreen payments because there was no process to manage leases approaching the end-of-term. In many cases, Cummins was forced to buy out the equipment because they could not return it on time.

In summary, the leasing process was broken and the company was losing a lot of money.

NEW LEASE MANAGEMENT PROJECT

The CFO initiated a project to drive savings and fix the process. Cummins needed a single, global, scalable leasing process. The ability to track leases, assets, stakeholders, and lessors across the leasing lifecycle around the world was needed. The company needed a software system that enabled decentralised decision-making while enforcing centrally administered controls. Critical to success was the need to maintain a complete, accurate, and centralised leasing database.

Example - 48 Month Lease

END OF THE LEASE

Evergreen fees resulting from lack of an end-of-term process

START OF THE LEASE

High lease price due to uncompetitive bidding

60

48

36

24

12

Forced buyouts from late returns

Tight relationships with captive lessors

TREASURY SPONSORED THE PROJECT

Treasury was the corporate sponsor for the initiative. However, Treasury collaborated with IT, Shared Services, and Procurement to consider, find, and implement a solution. IT led the requirements gathering process by interviewing all the stakeholders around the world.

Cummins discovered that equipment and real estate leases needed different solutions because they each had different stakeholders, counter-parties, processes, controls, reporting, and metrics. No system or vendor could do both well.

Cummins distributed RFPs to a long list of software vendors. After reviewing the vendor responses against the requirements, the list was narrowed down to two companies. A final, comprehensive evaluation of both vendors was conducted.

CFO
Executive Sponsor

Treasury
Project Lead

Procurement
Stakeholder

Shared Services
Stakeholder

IT
Stakeholder

SOFTWARE PLUS BUSINESS PROCESS CHANGES

INCENTIVES

TRAINING

EQUIPMENT LEASE PROCEDURES

POLICIES & CONTROLS

EQUIPMENT LEASE MANAGEMENT SOFTWARE

MORE THAN SOFTWARE

Through discussion and engagement with one of the vendors, LeaseAccelerator, Cummins realised that its original requirements were incomplete. Fixing the leasing program not only

required software, but also an up-to-date contract repository with all the original leases. Cummins concluded that starting with the incomplete, unreconciled spreadsheet data would have been much more complicated.

To ensure that the implementation and adoption of the software was globally successful Cummins needed to learn and adopt industry best practices. The cross-functional team had to deploy the software along with the necessary policies, procedures, controls, training, incentives, and support to drive adoption.

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VENDOR SELECTION

Cummins selected LeaseAccelerator for its Equipment Lease Management program. Using the Software-as-a-Service model, the application went live several weeks after the contract was signed.

LeaseAccelerator's application was configured to reflect Cummins' corporate hierarchy and General Ledger code structure. Key variables including Internal Borrowing Rate, Cost of Debt and Weighted Average Cost of Capital were defined in the system. The most complex part of the implementation was the collection and loading of the leasing documents.

REDUCING END OF TERM COSTS

With the database established, Cummins began identifying opportunities for cost savings. First, the leases exceeding their original terms were identified. Each of the evergreen leases was resolved systematically. The largest and oldest leases were eliminated first. Through returns and buyouts, Cummins pruned the total active leases down to approximately 3,500 leases. Over 56,000 assets in 31 countries were covered with the same run- rate as today.
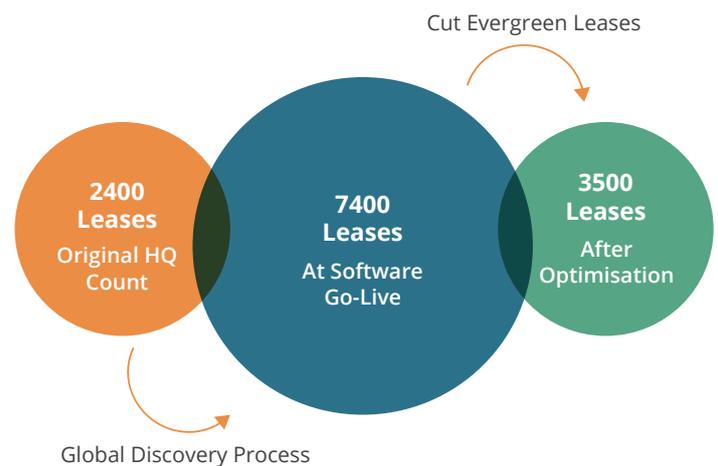
STANDARDISING LEASE VERSUS BUY

Deploying a single, global Six Sigma process for equipment leasing had some unexpected challenges. For example, Treasury required that everyone use LeaseAccelerator's lease versus buy analysis tools. Lease versus buy is the first control point in the leasing process and provided Treasury with the earliest visibility into potential lease transactions.

LEASE COLLECTION PROCESS

The database collection process began by scouring filing cabinets for active leases. The CFO sent a letter to all business units worldwide mandating that all lease agreements should be collected by the Shared Services organisation. Leases were catalogued and forwarded to LeaseAccelerator. Both schedule level information and asset detail were uploaded.

In the first six months, 2,200 leases from 44 countries were captured. Over 1,000 of the leases had to be translated into English first. Although Cummins had originally thought that it had 2,500 leases, the implementation process led to the discovery of several thousand more. In the end over 7400 leases were entered in the database.

Cummins lease portfolio

Cut Evergreen Leases

2400 Leases Original HQ Count

7400 Leases At Software Go-Live

3500 Leases After Optimisation

Global Discovery Process

To automate the on-going equipment lease management process, LeaseAccelerator was integrated with Ariba Procurement and Oracle reporting.

Within nine months the CFO's objectives were met.

To get the data, the process had to be simple. LeaseAccelerator's Asset Request Form (ARF) provided the solution. ARF is a simple, lightweight, standardised Microsoft Excel spreadsheet that a user can complete and send by email directly to LeaseAccelerator. A detailed Lease versus buy analysis and indicative ASC 840 test are returned in PDF via email to the user within minutes. The location and rates (maintained monthly by Treasury) are automatically determined by the system for the calculations. Since 2010, Cummins processed approximately 8,000 ARFs in 38 countries.
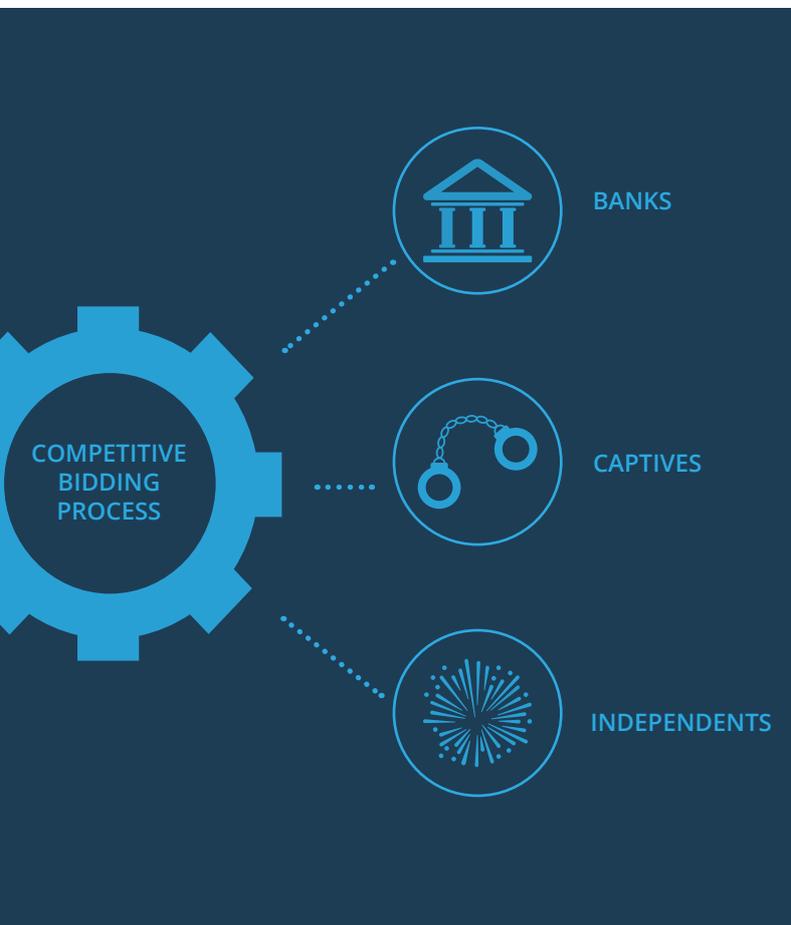
ASSET COST ┈┈┈➤

IBR ┈┈┈➤

WACC ┈┈┈➤

LEASE TERM ┈┈┈➤

LEASE VERSUS BUY ANALYSIS

⬅┈┈┈ LEASE NPV

⬅┈┈┈ BREAK EVEN ANALYSIS

⬅┈┈┈ NET CASH FLOWS

⬅┈┈┈ TAX DEDUCTION

BANKS

CAPTIVES

INDEPENDENTS

COMPETITIVE BIDDING PROCESS

COMPETITIVE SOURCING

With the lease versus buy data, Cummins can quickly launch a competitive sourcing event for lease capital. With a few clicks, the buyer can generate distribute an RFP to interested lessors. LeaseAccelerator offers access to a competitive marketplace in which lessors from The Global Lessor Network (GLN) can submit their bids. Then the buyer selects the winner, typically the lowest bidder, and completes the transaction. The winning lessor submits the final documents and data, which are then loaded into LeaseAccelerator and booked.

Using LeaseAccelerator, Cummins can control its processes of sourcing capital and booking transactions. Using the notification and attestation capabilities, accounting can track any asset-level changes in location or business coding over the term of the lease. Stakeholders can manage end-of-term events such as buyouts, renewals, and returns. Each business unit's performance can be tracked centrally. Standardised reports provide equipment managers and their supervisors with scorecards about how much they have saved or lost the company.

SUMMARY OF BENEFITS

Since inception of the project, Cummins has run approximately 9,000 leases through "the global leasing process" with an original equipment value approaching US$800 million.

Reduced Cost of Equipment Leases:
Before this project Cummins did not have a competitive lease bidding process. Now, competing lease transactions is a company-wide standard practice. Through the automated RFP process, over 73 competitive sourcing events have been completed in 26 countries.

The new competitive model yields with an average cost of savings 8% per lease.

Better Lease Portfolio Management:
Before this project, Cummins was losing a lot of money in evergreen payments and forced buyouts. Since the new equipment lease management strategy was implemented performance has improved consistently each year. Negotiated savings have been converted to realised savings, driving bottom-line performance. Evergreen payments as a percentage of total annual payments (excluding termination fees) dropped from 18 percent at program inception to an average of 8.5 percent in subsequent years. The "unplanned/unintended" portion of spend dropped by more than half.

Established Policies and Controls:
Specific policies and controls were put in place throughout the lease lifecycle. This resulted in better operational and financial controls.

Ready for New Lease Accounting
Standard: Cummins has also removed the uncertainty of transitioning to the new lease accounting standard. The software will make the appropriate calculations for the current standard and the new standard, enabling Cummins to generate multiple sets of books and parallel reporting. Additionally, the company can use the tool on a daily basis to maintain the accuracy and completeness.

Competitive Edge:
Better lease management provides Cummins with an edge over its peers in the Industrial Manufacturing sector. Cummins is in the process of acquiring its North American distributors. LeaseAccelerator has made the merger integration process smoother, loading the distributor lease portfolios into the application and then converting the units into the global leasing process.

Increased Visibility:
All stakeholders have visibility into the lease portfolio and the leasing life cycle. The visibility was achieved using the lease versus buy process, automated notifications, and online reporting tools.

Goals, Metrics, and Best Practices:
Cummins achieved the CFO's goal of fixing the process as well as the Treasurer's goal of cost savings The company now has well-defined processes and controls. There is still opportunity to further reduce costs at the end-of-term. However, Cummins equipment lease management processes are now based on best practice.

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Learn more at:

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