U.S. EQUIPMENT LEASING & FINANCE FOUNDATION
PUBLISHES GROUNDBREAKING WHITE PAPER ON CHINA

ARLINGTON, VA,– A growing number of lessors exhibiting cautious optimism are slowly, but successfully, knocking down the great wall that separates them from turning lease financing into a mainstream financial product in China to help companies acquire critical equipment.

This sentiment is summarized in a white paper on China today released by the Equipment Leasing & Finance Foundation.
Like any new market, China presents a number of formidable – sometimes daunting – challenges for lessors. Overcoming them as the country moves toward a market-based economy makes the job that much more compelling. Careful planning and execution, however, are leading to success for early entrants.

“The penetration rate of leasing in China is less than one-half of one percent, as compared to the prevailing level of 30 percent in the United States and other mature markets,” said Foundation Executive Director Lisa Levine. “Obviously there is tremendous growth potential for the Chinese leasing industry. As the Chinese economy continues to evolve, learning from the experiences of early entrants – both good and bad - could determine the chances of success or failure for new lessors.”

The Foundation commissioned The Alta Group consultancy to develop the white paper entitled, “Knocking Down the (Great) Walls: Identifying Factors for Success in the Chinese Equipment Leasing Market,“ available through the ELA.

“To many people in our industry and business in general, China represents this big morass of unknowns,” said Alta Group Managing Principal John Deane. “This white paper helps companies secure a better understanding of the Chinese market and determine the minimum requirements for operating there, including risks that must be addressed to be successful.

“Many of the lessons learned by lease finance providers in China and discussed in the paper can actually be transferred to companies in other industries who are evaluating such a move to this burgeoning market.”

Content for the white paper was derived largely through extensive interviews with a number of lessors currently operating in China. The document includes case study overviews of each of their experiences. The interviewed lessors include, among others:

- A captive lessor whose parent is a large, United States-based manufacturer of industrial equipment;

- An international technology company whose China leasing activities are conducted by a joint venture leasing company with a Chinese lessor partner;

- A Hong Kong-based bank that writes offshore leases into China;

- A local Chinese-owned lessor; and,

- An international bank-owned equipment lessor that has studied the China equipment leasing market carefully, but has chosen not to enter the market yet.

“Our research indicated that the infrastructure needed for a viable equipment leasing industry in China is not fully in place,” Deane said.

“As a result, it’s critical that lessors be armed with adequate and accurate information regarding the opportunities and pitfalls in this market. Many of the risks in China are the same as those in other markets, except they are compounded by time and distance. There also are some uniquely Chinese beyond differing tax and accounting rules.”

Key findings discussed in the white paper include:

- There are plenty of risks in doing business in China, but nothing that cannot be overcome through diligence and careful planning. Of greatest concern are credit reporting and the legal environment in China, both of which are extremely challenging – as are the regulatory process and tax system. The understanding and acceptance of leasing is improving, however, helping lessors carefully maneuver through these obstacles.

“Central databases of credit histories just don’t exist in China, so you can’t run your business there like other markets,” Alta principal and co-author Jonathan Fales said. “Consequently, you need to know your customers on a personal basis. Local lessors and those with Chinese partners have this knowledge and advantage. Over time, this process will become more westernized, but this is still several years away.”

• Unless there is a customer-driven need, most foreign lessors should not enter the market just yet. Given the risks involved, waiting until the market is better prepared for modern lease financing is prudent. But, if it appears a customer or parent company will need lease finance support in any way, there should be no hesitancy to move into China and establish operations.

“When the timing is right, the sooner a lessor enters this market the better chance they have at grabbing a foothold of business,” Fales said. “There are some risks to be sure, but the sooner you get to China and establish your operation, the better shape you will be with a few years of experience before the expected rush into the market later this decade.”

• More than one business model seems to work for lessors in China. Wholly foreign-owned enterprise (WFOE), joint venture, offshore and Chinese-owned onshore lessor arrangements all seem successful, depending on the specific needs of the lessor and customer. Partnerships with Chinese lessors can shorten the time to market, but it can be difficult to find a suitable partner due to a variety of cultural differences and control issues.

“Based on our analysis of the leasing industry and benchmarking of other industries where foreign investors have ventured into China, we’ve found it advantageous for a foreign lessor to team with a Chinese partner,” Alta Principal Rafael Castillo-Triana said. “Finding such a partner with financial stability and significant experience in leasing can be a challenge but, if the right one is found, this can ease a lessor’s entrance into the Chinese market.”

• Business plans must account for an acute shortage of local talent in China. Across the globe, the leasing industry is insular and has had to largely train its own people. This situation is surprisingly even more exaggerated in China. Most executives come from the traditional banking and finance industries, with little if any exposure to the practice of lease financing. Significant recruiting and training resources must be dedicated to address this situation.

“At this point, if you talk to the major lessors in China and ask them who the key people are in the industry, you hear the same set of names from each,” Fales said. “The talent pool to service the market needs to grow significantly before leasing will become a mainstream industry in China.”

- Leasing is still a new concept for many Chinese businesspeople. There is a surprisingly low level of understanding of basic lease finance concepts in China, even among vendor and reseller executives. Significant marketing and training resources must be dedicated to overcome this issue.

“Virtually all of the lessors we interviewed were amazed by the fact that leasing is not a well understood concept in China, despite the emerging market economy,” Castillo-Triana said. “They realize time and effort are needed to educate this evolving market on the advantages of leasing.”

- The used equipment market in China is largely undeveloped. Chinese businesses have historically avoided used equipment due to a combination of reliability concerns and negative connotations associated with the purchase of used equipment. There is great potential to build a strong used equipment market for some assets, including IT and telecom equipment.

“Perceptions toward used equipment are slowly changing, especially as foreign manufacturers with better quality equipment enter China,” Fales said. “People are starting to realize, for example, that a piece of machinery or construction equipment three or four years old may actually be in good shape and worth buying on the used-equipment market. This is another cultural issue that is going to take some time to overcome.”

- Patience is critical in establishing any business in China. Little happens fast in this country. Both Chinese and foreign lessors have painfully experienced the lengthy process of securing government approvals. Just trying to secure a signature on a simple document sometimes takes months. As a general rule of thumb, plan double the time needed when working in this market place.

“When it comes to business, anything the Chinese government touches takes a lot longer to get done than other countries, but this is true for virtually every industry in the country,” Fales said. “This certainly increases the time needed to get into the market. Once a lessor decides to enter China, it takes at least 6-9 months, probably longer to get everything in place to do business.”