EQUIPMENT FINANCING

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GUEST ARTICLE

If FY20 was a bad year for Construction Equipment with an election-induced construction slowdown, liquidity crises, slump in manufacturing, and sporadic floods; FY21 couldn't have started on worse note. The on-going Coronavirus, or more specifically Covid-19, outbreak threatens domestic and global growth for at least the first quarter of this fiscal.

Even if we manage to contain the outbreak, re-organizing the migrant workforce and overcoming the initial supply-chain hiccup will take some time. That the second quarter is a monsoon period, which markedly impacts construction, doesn't help the situation either. The Construction Equipment sector which saw a CAGR growth of 24 per cent between FY15 and FY18, witnessed a de-growth of about 30 per cent in FY20. The Construction Equipment Finance sector was impacted similarly.

However, India's long term growth story remains intact. The government realises that economic growth cannot be achieved without a growth in infrastructure. Worldwide, redoubling of investment in infrastructure is a key strategy to counter the impacts of a downturn. The government has begun the exercise of creating a national infrastructure pipeline with a vision to invest Rs.100 lakh crores in infrastructure over the next five years. Already highway projects worth approximately Rs. 15 Lakh crores have been identified. Once these investments materialize, we will soon see positive impacts in sectors such as cement, steel and automobiles, besides of course the infrastructure and construction equipment sectors.

For infrastructure segments like road, which has seen a lion's share of such investment in the past, the equipment intensity (equipment cost as a per cent of overall project cost) is as high as 15-20 per cent, while for the other segment it ranges between 5-20%. I believe, we will shortly see the industry revive and achieve the 20 plus per cent growth it had witnessed in the recent past.

I am a firm believer that every crisis is an opportunity to do things you could not do before. The crisis will accentuate some promising trends which had begun to appear in the equipment financing sector in the recent past.

The first transformation which is happening is automation of process. Traditional financing process which used to take weeks has now been reduced to a few days or even hours. Today, Fintech technology platforms continue to disrupt traditional financing processes. Hybrid companies which combine select Fintech tools and technologies are emerging. So are platform-based offerings which allow customers, equipment manufacturers, service providers and financiers to interact seamlessly and creating value in the process.

The second transformation is shift in the customer's behaviour from owning a product to requesting a service. There has been emergence of companies providing service rentals and pay-per-use models which is dramatically changing the total cost of ownership for the customer.

The third transformation revolves around the equipment itself, where IoT technologies, less expensive sensors and connected devices are transforming how we interact with the equipment and drive efficiencies.

I believe that the current scenario will push customers to go digital, and rethink about the entire concept of owning an asset. The economy today faces a unique problem – the need for investment at a time when the banking system is under-capitalized and is only able to offer a limited range of products. Today, SME's - the growth engine of the nation, face the challenge of insufficient collateral or credit history to access traditional bank finance. This results in a shortage of credit available to entrepreneurs.

In a time like this, leasing can play a big role in reviving investments. Across many developed and developing economies globally, leasing of equipment and real assets is a prominent source of private capital formation and contributor to GDP. For some of the developed nations globally, the equipment leasing as a percentage of private capital formation is as high as 40%. In India however, the leasing penetration is abysmally low at less than 3%.

Put simply, leasing splits ownership and user – ownership remains with the lessor, and use moves to the lessee. Leasing is based on the premise that profits are earned through the use of assets, rather than from their ownership.

Leasing extends numerous advantages over other financing methods. Under leasing, the procurer is relieved from making any upfront capital investment, thereby allowing the user to enter a project at a lower cost of capital. Another important advantage of leasing is the elimination of risk of the equipment being obsolete and outdated for the procurer.

Leasing increases the availability of capital, improves operational efficiency and, as a result, potentially contributes to wealth creation, and thus economic growth. More than economic growth, a leasing economy incentivises the manufacturer to focus on the equipment life-cycle, rather than just selling the product. This has far reaching impact on the product durability and sustainability, and can lead to a circular and self-supporting economy.

It is important that both industry and policymakers realize the potential that leasing can have in economic wealth creation. Industry participants should promote leasing and educate small entrepreneurs of its utility. Leasing is very sensitive to taxation. Policymakers should focus on incentivizing creating a conducive taxation environment for leasing activities to prosper. Perhaps the best way to start would be to support NBFCs who have been for a long time now the only flag bearers championing this cause, in the absence of banks.

I firmly believe that the year 2020 will be the year of Leasing. CM

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