Leaseurope Comments on the Lease Society Model

A background note in advance of the ENVI Committee meeting of 21 March 2013

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Leasing in Europe

Leasing is a major source of investment support for European businesses[1]. It is used across the board by companies of all sizes and in all industries as well as being extremely useful to support consumers and the public sector (i.e. leasing to schools and hospitals). In 2011, European leasing companies (lessors) financed assets worth more than €256 billion and enabled 20.8% of all equipment investment in Europe[2].

Leasing is particularly appropriate for small businesses[3]. Over 50% of all leasing to businesses is made to SMEs and an estimated 40% of all European SMEs used leasing in 2010, which is more than any other individual form external funding[4].

Who are European Lessors?

Leasing companies can be banks or bank-owned subsidiaries, the financing arms of manufacturing companies, which are known as captive lessors, or independently owned companies[5]. There are about 1,300 leasing firms in Europe.

ENVI considers leasing as a way to address unnecessary waste and depletion of resources

In 2012, MEP Judith Merkies (ITRE and ENVI), released a booklet entitled, "The lease society: the end of ownership." The booklet discusses how a leasing model, if deployed on a large scale throughout European business and society, can lead to a more sustainable, circular economy.

The ideas set out in the booklet were further developed by the Wuppertal Institute for Climate, Environment and Energy in their study "Leasing Society" commissioned by the ENVI Committee and published in November 2012.

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[1] Sources: Leaseurope; Eurostat (2011) *Access to Finance Statistics*; Oxford Economics (2011) *The Use of Leasing Amongst European SMEs*; International Finance Corporation (2009) *Leasing in Development: Guidelines for Emerging Economies*; European Investment Fund (2012) *The importance of leasing for SME finance*; and UEAPME (2012) *UEAPME Newsflash*.

[2] Leaseurope calculation based on new leasing volumes as a percentage of gross fixed capital formation (GFCF) in equipment. Leasing volumes are taken from Leaseurope's Annual Statistical Enquiry 2011, GFCF equipment figures are taken from the European Commission's DG ECFIN database AMECO extracted on 12/09/2012.

[3] Oxford Economics (2011) *The Use of Leasing Amongst European SMEs* and European Central Bank (November 2012) *Survey on the Access to Finance of Small and Medium-Sized Enterprises in the Euro Area*.

[4] Oxford Economics (2011) *The Use of Leasing Amongst European SMEs Report*.

[5] We refer to bank and independently owned lessors as 3rd party lessors as opposed to manufacturer owned lessors known as captive lessors.

The booklet sets out the resulting consequences arising from today's European society and business models:

i) **Excessive waste of natural resources and the on-going harm being done to the environment**. In other words, the concern that consumerist behaviour and the so-called "planned obsolescence" of goods may lead to an excessive tapping of resources and mining of raw materials, possibly resulting in the depletion of natural resources.

ii) **Producers of goods are not incentivised to create long-lasting and dependable products**, but instead have an interest in frequently issuing new products to replace existing models (thus, generating unnecessary waste).

iii) **An increasing reliance of European manufacturers on resources that originate from outside of the EU** and, in particular, from "resource-abundant second and third world regimes" (necessary to produce these new assets).

The Lease Society Model

According to the authors of the above-mentioned publications, the so-called "Lease Society Model" could address these concerns. Their hypothesis is that, by encouraging manufacturers to lease[6] instead of sell the goods they produce, they would be incentivised to create durable, high quality products that can easily be disassembled, reused and/or recycled. In turn, this would decrease the reliance on limited/external resources and prevent a "waste culture" from developing. In order for this to occur, this implies that users of goods would have to shift their mind sets and accept the concept of making use of the services a product provides (i.e. start leasing) rather than owning a product outright.

A hearing on the Lease Society Model will be held on 21 March in the ENVI Committee. In advance of this hearing, we wish to bring some issues to your attention.

Initial reactions of the European leasing industry

Leaseurope, the Federation representing the European leasing industry, very much supports the use of leasing as a means to incentivise producers. Additionally, we agree that the more end users are willing to accept leasing as preferable means to obtain the use of assets (rather than owning them outright), the more leasing will be able to bring in the benefits envisaged under the Lease Society Model.

[6] Under a lease, while the client can make use of an asset for a period of time, it does not own the asset. It is the lessor that remains the owner of the asset throughout the lease contract.

However, in the context of the debate on this concept, we consider that it is important that MEPs take the following issues into account when deciding on next steps:

1) **Leases can be provided with the same effects by either 3rd party leasing companies (i.e. non-manufactures, like bank-owned or independently owned firms) *or* manufacturers**. In other words, regardless of whether the lessor is a bank, manufacturer or other type of company (or even an individual), it will always remain the owner of the good throughout the lease and, thus, will have to deal with the consequences of ownership. These consequences can include: dealing with the asset after the contract, possibly ensuring the asset functions correctly and bearing costs related to its maintenance during the contract, etc.
2) In practice, **3rd party and manufacturer lessors often work in partnership to develop lease solutions** (these are often known as vendor programmes). 3rd party lessors, such as the leasing subsidiaries of banking groups, typically have access to funding and are therefore able to channel funds towards clients so that they can use leased assets. 3rd party lessors also bring various systems and back office expertise (e.g. credit scoring, recovery processes, etc.) to the partnership. Manufacturers on the other hand do not necessarily have similar access to funding or the same level of expertise in managing financial risks (although some do develop this knowledge in house). Nevertheless, they play a very important role in relation to the asset, for instance, by taking on the risks related to the asset (e.g. through the provision of guarantees). This means that manufacturers have an interest to ensure the asset is of value throughout and after the contract term.
3) **Leasing companies have developed sophisticated asset life cycle management programmes.** Lessors are experts in finding new homes for 2nd hand assets, thus, extending an asset's useful life. They also have unique expertise as they understand the entire life cycle of an asset, from its conception to the end of its life. This allows for the efficient design of assets, with easily detachable, reusable and recyclable components. Working on their own or together with a network of partners[7], they ensure the servicing of the asset throughout the lease contract. Leased assets are also better maintained than privately owned assets, resulting in a further extension of asset life times. The end result for the client is a seamless solution for using assets without having to worry about the often complex consequences of ownership.
4) **Leasing is an excellent tool for promoting new and cleaner technologies.** For instance, by allowing and encouraging the uptake of clean vehicle technology, the leased car fleet in Europe has become steadily less polluting over the past few years[8]. Similarly, recent research has also recognised the importance of leasing to achieve the required rejuvenation of European truck fleets in order to adopt necessary fuel-saving technologies[9]. Additionally, leasing can help address one of the general barriers that inhibits the development of sustainable energy production, i.e. a lack of access to capital[10]. In fact, leasing already facilitates the financing of equipment such as wind turbines, biofuel processing plants, photovoltaic panels, long lasting battery cells and so forth, allowing Europe to produce cleaner and more sustainable energy.

[7] "The Lease Society: The End of Ownership" pg. 25-6, stresses the need for designers, manufacturers, banks and the waste-industry to work together under a lease society in order to foster circular business models so that Europe can meet sustainability goals for a climate neutral EU in 2050.
[8] Leaseurope (2012) Between 2009 and 2011, the average CO_2 emissions of newly purchased vehicles in a leased fleet of 6 pan-European companies' active in 8 European markets decreased from 149 g/km to 133 g/km.
[9] CE Delft (October 2012) *Market Barriers to Increased Efficiency in the European On-road Freight Sector* – report presented during a European Commission (DG CLIMA) workshop held in Brussels on 15 October entitled "Onroad Freight Efficiency Technology Market Barriers".
[10] International Finance Corporation (2009) *Leasing in Development: Guidelines for Emerging Economies*.

5) **European manufacturers already have to abide by the Waste Electrical and Electronic Equipment Directive[11] (WEE) as well as End-of-Life Vehicles Directive[12]**. These Directives ensure that assets are designed and produced in such a way as to facilitate their dismantling, recovery and recycling.
6) **An increased uptake of leasing and, by extension, the Lease Society Model will only become a reality if it is economically justifiable**. It is important to note that in many lease situations today, if a manufacturer retains a high level of asset risk, it is not able to recognise sales revenues upfront (as accounting standards will not consider such transactions to be sales). Manufacturers will therefore tend to privilege lease programmes and cooperation with 3rd party lessors that allow them to recognise sales and, hence, upfront revenue. This further reinforces the importance and need for partnerships between manufacturers and lessors as it is stressed in “The Lease Society: The End of Ownership”.

We look forward to observing the debate that the ENVI Committee will have on this topic and are at your disposal should you wish to have more information on the benefits of the leasing product or how the leasing industry can contribute to the development of a Lease Society Model.

Yours sincerely,

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[11] DIRECTIVE 2002/96/EC
[12] DIRECTIVE 2000/53/EC