CREDIT

Getting the credit application right is more important than ever

Derek Soper

Already we are hearing about profit warnings on an almost daily basis. Coupled with this, is the speculation that many banks will have more bad news for their shareholders as the impact of the collapse of US sub-prime mortgages works its way through the world's financial system. Are there major implications for our equipment financing market and, if so, how will they manifest themselves?

Like all news, there is some good and some bad, depending on where you are in the scheme of things. I imagine the likes of State Securities and Close Leasing Limited (see article in this issue on page 12) are delighted there will be many organisations that will no longer fall into the 'acceptable' box of any of the major lenders.

These 'marginal' credits nevertheless will need continual access to sources of finance for the acquisition of new equipment if they are going to continue to compete in an increasingly difficult market. If balance sheets, cash flow, falling profit margins and a lack of general confidence in the UK economy are all going to be with us for some time, the narrative background accompanying a credit proposal – the 'story' part of the 'story credit' – will have to be a good one.

Coping during crisis

The intriguing part of all this is how well major asset financiers cope with the reduced confidence in the market and the usual flight to 'quality' when the market is expecting a downturn. To what extent they also integrate the 'story credits' into their credit process, and how much they charge for the privilege, is also a major factor as the finance companies struggle to maintain their profits.

In other words, will we see a credit compromise aided and abetted by an increase in rates or can our industry be stony faced about the current situation and weather the storm? Most experiences over the past two decades have been to weather the external storm – this time around the storm is also raging within the major banks as sub-prime write-offs gather pace.

Effects of the wider economy

To what extent the credit crunch will affect the wider economy still remains to be seen. What is clear, however, is that there needs to be much stronger emphasis on risk analysis tools, which are becoming crucial to asset finance activities, not only because the industry is becoming more competitive, but also to fit in with the increased regulatory initiatives and an uncertain global market place.

If asset finance providers are to be successful in coping with increased risk, far greater levels of data accuracy, analysis, process transparency and risk modelling are required. Many of the smaller asset financiers have struggled with regards to risk modelling. This is in mark contrast to the larger operators – mainly bank subsidiaries – which have greater access to risk-focused technology at their disposal due to the huge variety of lending undertaken by their parents and the well-embedded 'portfolio management' culture so favoured by the supervisory authorities.

The most voiced industry issue in the latter half of 2007, and which is still being aired in 2008, is the deepening credit crunch. It remains to be seen just which way the asset finance industry will be affected, but it is already clear it has highlighted the necessity for adequate risk mitigation and business controls.

With purse strings continuing to tighten, asset financiers must ensure pricing and risk are based on tried and tested processes and high quality decision making. Let's remember, however, there will always be room for the well-researched 'story credit'.

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