THE EFFECTIVENESS OF ALTERNATIVES TO PURCHASE IN THE MARKETING OF CONSTRUCTION EQUIPMENT THROUGH DISTRIBUTORS

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ABSTRACT

THE EFFECTIVENESS OF ALTERNATIVES TO PURCHASE IN THE MARKETING OF CONSTRUCTION EQUIPMENT THROUGH DISTRIBUTORS

by Alvin Jay Bytwork

Rentals, rental-purchases, and straight leases are the principal alternatives to purchase in the construction equipment industry. Rentals are primarily of used equipment for needs of less than a year where there is no intent to purchase. A rental-purchase contract is for a longer period with a purchase option attached to facilitate possible sale. Straight leases have no option to purchase, although aggregate payments must equal the purchase price over an average period of three years.

A selective study was designed to investigate:

1. Whether the alternatives to purchase were as profitable as sales, and

2. Whether marketing effort influences the volume and profits of rental-leasing.

In addition, the study was aimed at describing some marketing implications and adjustments for the alternatives to purchase.

The rental-leasing literature relevant to construction equipment was examined. Facets of the major problems which appeared were consolidated into a questionnaire. Subsequent interviews and a pretest guided the reformulation of a final questionnaire which was sent to a national random sample of the AED (Associated Equipment Distributors). Cost and

operating data were available from the AED. A cross-check of these data with those received from the respondents indicated that the respondents were typical distributors. Answers to the questions revealed both attitudes and practices. A comparison of this information with that obtained in a similar survey of contractors, the primary distributor customers, indicated that while distributors clearly perceived the reasons why contractors rent, they did not correctly evaluate the reasons why contractors lease.

Major findings on the central problem include:

1. The alternatives to purchase have profit margins comparable to those of sales.

2. These alternatives can increase (or retard the decrease) of total income and profits; however, a rental is often in lieu of an outright sale.

3. There is no consistent ranking of the alternatives to purchase according to highest profit margins.

4. Most distributors do not expand marketing efforts according to the profits they earn from each alternative. Attitudes toward rental-leasing sometimes divert their efforts.

5. When distributors directed their marketing efforts according to the profit margins, they earned profits above the median of all distributors.

6. About one-fourth of the total marketing effort is for rental-leasing, which accounts for a similar proportion of total income.

Alvin Jay Bytwork

On the additional issues, the findings are: (1) Credit requirements and tax considerations make it advisable to evaluate the market segments for each alternative prior to conducting marketing efforts. (2) There are different primary advantages and disadvantages for each alternative to purchase. (3) Distributors often grant free maintenance; therefore, they should arrange plans and rates to include some maintenance. (4) Independent professional lessors can often provide valuable marketing aids for the distributor who does not possess the necessary operational facilities.

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I appreciate the efforts of my wife in the typing of the drafts while caring for increased duties. Finally, I stand in humble reverence before Almighty God for providing the opportunity, clear mind, and good health necessary for accomplishing this task.

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CHAPTER I

HISTORICAL CONCEPTS, PROBLEMS, AND PRACTICES

Introduction

Rental-leasing in the construction equipment industry exists in three principal variations: rental, rental-purchase, and straight (or true) leasing. The last is the newest and least known so it will be defined first.

A true equipment lease is a marketing method to distribute machinery to a user for a long-term (usually a period of three years or more), without purchase option, while title remains with the seller or is transferred to a third-party. This definition has found acceptance in the literature and in common usage. The true lease plan does not include an option to purchase within the contract.[1] Mr. Bruce McNab, in his thesis, recognizes this definition although his leasing discussion is very general and does not single out true leasing. The true lease plans and arrangements can be quite varied. Jones and Lamson Machine Company have four true lease plans.[2]

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[1] Bruce McNab, "The Lease as a Device to Market Equipment" (unpublished Master's thesis, Department of Business Organization, Ohio State University, 1959), p. 125.

[2] "Leasing . . . New Twist in Marketing Grows as it gets Older," Industrial Marketing, February, 1956, p. 57.

Clark Equipment Company recognizes the lease without a purchase option as a straight lease. Others do likewise. Following general practice in this paper, true and straight leasing will be used interchangeably.

Straight leasing is narrower in definition than the following one of a general lease.

> Legally, a lease is a contractual arrangement under which the use of an asset is transferred by its owner for a certain period of time to another party for a consideration.[1]

The definition used in this paper denotes a more precise area of leasing. The straight lease, as used in about 45% of this paper, can also be prefaced with the adjectives--non-cancellable and finance. Together, these adjectives mean that the lessee (user) must pay, over a period of time, for the total cost of the equipment. These are terms that can be applied to the lease although they are not used in every instance. Short-term leasing has been distinguished from long-term leasing as being for a period of less than three years.[2] While no legal distinction exists, rental is generally designated as having a time span of less than one year.

Leasing of equipment started in the United States in

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[1] D. Maynard Phelps and J. Howard Westing, Marketing Management (Homewood, Illinois: R. D. Irwin, 1960), p. 321.

[2] Richard Vancil and Robert Anthony, "The Financial Community Looks at Leasing," Harvard Business Review (November-December, 1959), p. 127.

pre-Civil War days when Mr. G. McKay could not sell his sole-stitching shoe machine, so he decided to lease it.[1] The general leasing trend then had its start. Part of the stigma attached to leasing as a subaltern method of marketing may also have had its conception from this beginning circumstance. "The attitudes of the sales staff toward leasing as a 'last resort' can adversely affect the success of the leasing operation."[2] A segment of the rental-leasing movement, the straight lease, came into prominent recognition about a decade ago. "A major food corporation's need for equipment in 1952 marked the beginning of diversified equipment leasing."[3] Ten million dollars worth of equipment was marketed by the true lease in 1952 and in 1959 this type of plan accounted for two billion dollars of sales.

Most companies that have used this type of plan, as reported in the literature, are satisfied with the results. Many more concerns are planning for the use of leasing. It may be a marketing trend that has important future significance.

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[1]Francis A. Babione, "Marketing Equipment by Leasing" (unpublished Ph.D. dissertation, Department of Business Organization, Ohio State University, 1949), p. 87.

[2]Personal interview with Mr. Ben Williams of the Wood Office Furniture Institute, Kellogg Center, April, 1961. He is owner of Office Lessors, Elkhart, Indiana.

[3]J. Kane, "Coming of Age of Equipment Leasing," Burroughs Clearing House, Vol. 44 (March, 1960), p. 12.

Significance of the Problem Area

This study, though limited to construction equipment distributors, will hopefully add to the knowledge of the marketing ingredients present in rental-leasing, to enable leasing as a marketing method, to be utilized in the most profitable manner. The study does not purport to analyze the marketing mix of the outright sale, but it will differentiate between the marketing approach needed for selling and the one utilized in rental-leasing.

Historically, leasing has been defined as a financing and selling device. In mid-1944, however, it was put into the framework of marketing and called a marketing tool. To see the true significance of rental-leasing, one should review the connotations assigned to it. In its conception, rental-leasing was thought to be a manipulation tool used to make a "sale" by a different approach. Now that its use is becoming more prevalent, many consider that it is in the category of another marketing plan--such as a time payment plan. Not everyone accords that significance to it. Although leasing has grown in importance, in a recent book it was referred to as just a "pricing device."[1] Others view it as a promotional device or a sales closing tool. Whatever

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[1] D. Phelps and J. Westing, loc. cit.

nomenclature is assigned to rental-leasing, it is an important part of many marketing programs.

We have proceeded a long way from the industrial revolution. Mass production is a possibility with almost every type of manufactured good that is produced in our economy. Yet in spite of all of the finished products, we have difficulty in distributing adequate portions at various times. We have inventory build-ups in some areas far in excess of those needed or desired. In a time of concentrated effort on mass production, mass distribution was neglected. Now with major attention being placed on product distribution, rental-leasing must be examined for development of its full potential as a distribution tool.

Leasing contracts and arrangements are a complicated phase of marketing effort. In coping with these complications, we must examine basic business concepts.

Practical Importance of this Study

In this paper an attempt is made to differentiate the variations of renting and leasing. The word "leasing" is applied to so many different types of distribution plans that the advantages of one are often confused with the advantages of another. When the advantages of all of the plans are combined, it seems as though everything that is marketed should be leased. It is then wrongly advanced as the panacea for marketing ills.

No systematic recording of the extent and growth of leasing has been made. This paper makes a prognosis of growth on the basis of some trends and business conditions that affect leasing.

When practical, the full details concerning the approach of rental-leasing are given. In the construction equipment industry, there is renting being done by the distributors and contractors to other contractors; and leasing being done by the manufacturers, distributors, specialized construction lessors, and bank lessors. Each approach may have a different effect upon the future of leasing and when this is true, the different approaches of rental-leasing will be discussed.

There are many questions that must be resolved for leasing to make its most profitable contribution. Jones and Lamson Machinery Company studied leasing programs and compared alternatives for six months. Then, after beginning the program, they had to make major changes during the first month of leasing operations.[1]

If many practices and effects were made clearer, more companies might find leasing to be to their benefit. If

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[1]"Selling Now Means Leasing, Too," Sales Management, March 18, 1960, p. 18.

companies can use methodological tools to analyze the financial arrangements of leasing, the changes in marketing strategy and policy that must be implemented, the added risks, and the altered market structure; then they might find leasing a more manageable and important tool. The finance studies of leasing have fostered important progress lately in comparing costs for the lessees; marketing studies have been less successful, thus far, in revealing the market considerations for the lessors.

Distinctions in Rental-Leasing Operations

To summarize some of the characteristics already mentioned and to facilitate the examination of rental-leasing, a comparison can be made of some elements of the contract and practices.

TABLE 1

Comparison of Major Variations of Rental-Leasing

Characteristics	Straight Lease	Rental-Purchase	Rental
Contract for 3 years or more	Usually	Seldom	No
Purchase option in contract	No	Yes	No
Payments equal the price	Yes	Sometimes	No
Cancellable	No	Yes	Yes
"Sales" aid by financier	Usually	No	No
Year Practice began	1952[a]	1887 (approx.)	1861
Relaxed credit minimums	No	Seldom	Possibly

[a]Diversified leasing of many companies through an independent lessor.

The characteristics noted above apply to many industries although practices vary. For example, the lease by International Business Machines provides for a replacement of a machine when a superseding type is marketed, but a straight lease through an independent company requires the full contract period.

Problems of Rental-Leasing

Some firms, at best, tolerate rental-leasing as an unavoidable hurdle in carrying out their marketing program. The reasons for their feelings cover a wide range. Some of the reasons are unfounded while others show a realistic attitude. Companies find that they may be relinquishing their used product market to professional lessors who resell the equipment after the lease period. The analytical tools of investigating the effect of leasing on their market position have been absent, resulting in considerable uncertainty regarding profitability determinants.

To locate the specific problems of rental-leasing in the construction equipment industry for intensive study, a questionnaire pretest was given to selected distributors.[1] The pretest questionnaire responses show inferentially that

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[1]The questionnaire pretest was given to 30 members of the Associated Equipment Distributors, Sales Managers Conference, Kellogg Center, March 15, 1961. The pretest questionnaire and results are in Appendix I.

many diversified fears are latent in the minds of those who may start the long-term leasing of construction equipment. Therefore, part of this study is used to shed light on these obscurities and thereby give direction to the action of those who are in a position of influence.

After the problems of the distributors were probed, a final analysis for possible marketing adjustments was made using pertinent literature and some marketing theories for guidance. Some problems are not recognized by lessors; some are over-emphasized. The tables of advantages and disadvantages for the lessor-distributor, found in Chapter Five, illustrate areas of information for a new distributor philosophy.

Objectives of the Study

In this paper, some of the underlying marketing adjustments for rental-leasing are examined. In addition, the study will reveal the effectiveness of marketing by rental-leasing as applied in the construction equipment industry. These goals were decided at the provocation of one of the major writers on leasing--"possibly effects of a wider use of leasing on a single industry . . . are also worthy of consideration."[1]

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[1] Francis Babione, "Marketing Equipment by Leasing," Journal of Marketing, Vol. XV, No. 2 (October, 1950), p. 209.

Attention will center on construction equipment distributors and their use of rental-leasing. Concern will be centered primarily on the marketing and sales use of rental-leasing to increase the sales within the United States, since exporting was as low as $50 million out of $1.8 billion of construction equipment shipped in 1959.[1]

Of the 1200, 900 independently owned and operated distributors of construction equipment are joined voluntarily in the Associated Equipment Distributors (AED),[2] with headquarters in Chicago. All of the 1200 distributors account for 95% of the industry's products in the United States.[3] The 900 AED members account for about 80% of United States construction equipment distribution.

Specifically, this study focuses on how rental-leasing is used by the distributors within the construction equipment industry, how important it is to them, and the future of this type of marketing plan for them. Some of their attitudes toward it come to the surface. It is presumed by some, that one of the biggest drawbacks to leasing is not the loss of

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[1] The U.S. Industrial Outlook for 1960 (Washington: U.S. Department of Commerce, 1959), p. 177.

[2] This Association is referred to frequently and the initials AED will be used in future references.

[3] The U.S. Industrial Outlook for 1960, op. cit., p. 176.

ownership pride on the part of the buyer, but the loss of pride in salesmanship when "only a lease" is transacted.

The model on the following page shows the focus and interrelationship of the leasing problem.

Summary of the Problems

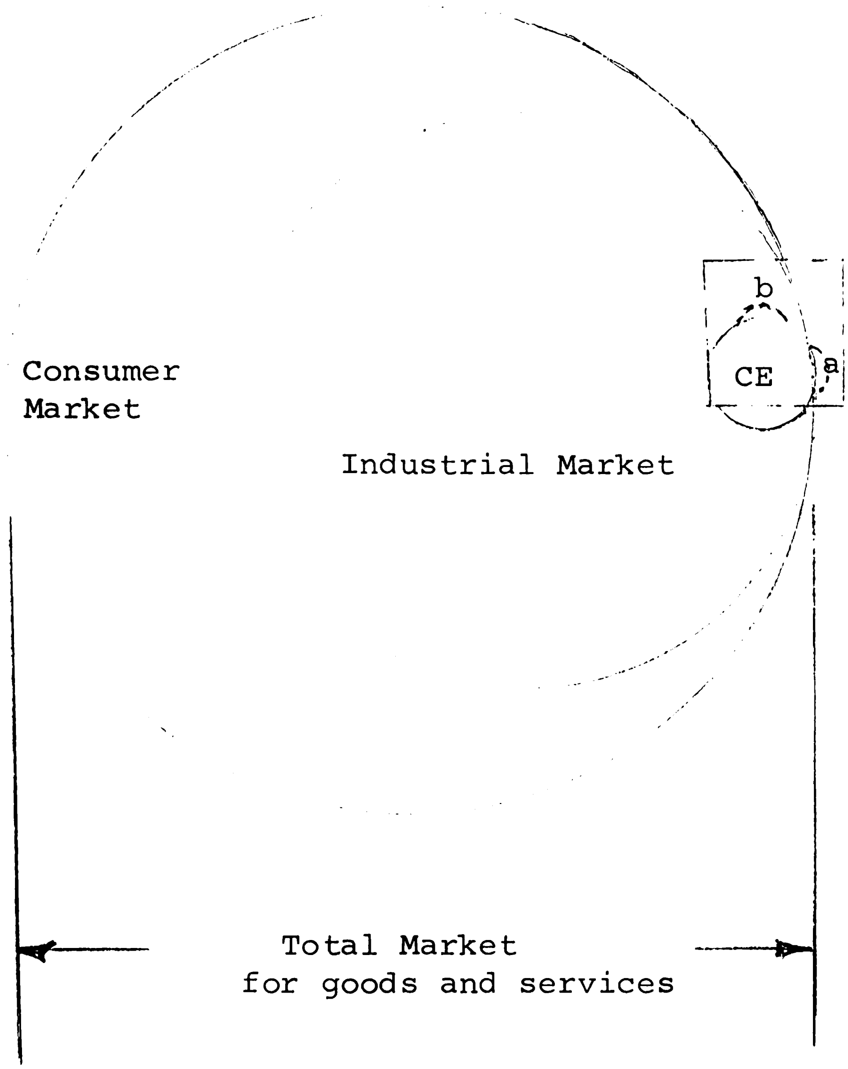
A search of the literature revealed many problems attendant to marketing goods through some variation of rental-leasing. Those problems that are most recurrent to enterprises that rent and lease are summarized in the following table.

TABLE 2

Some Major Problems Faced During the Growth of Rental-Leasing

By the Dealer	By the Customer
*1. Lessors may buy direct.	1. Uncertainty of tax treatment.
*2. Lose control of part of used-market.	*2. Lease requires payments equal to full price.
*3. Prospective customer may go direct to lessors.	*3. Less recourse for service than with rental or rental-purchase.
4. Contract and tax misunderstandings.	*4. If manufacturer plays greater role and dealer plays smaller role, the customer may lose his service facility.
5. Restrictions of capital financing.	5. Competition from dealer renting.
6. High inventory investment.	6. Increased competition from financially unsound lessees.

*Problems particularly acute in straight leasing.



CE is the construction equipment market
Does leasing expand the market (sales)? a---, b---

Note: It would be extremely difficult to differentiate between the expansion results of area a and area b.

——-——Area of investigation for this study.

Figure 1

Relation of Construction Equipment to the Total U.S. Market and the Area of this Leasing Study

Practices in Construction Equipment Marketing

Rental-leasing plays a large role in total "sales" of construction equipment. The bulk of it was brought about through competitive action for short-period equipment use. Rental activity began at about the same time as the distributor organization came into existence. Previously, the factories sold direct to contractors and serviced these accounts, but this proved to be cumbersome and unsuccessful.

Auction sales of construction equipment were not generally practiced prior to 1957. Since that time, they have been used to sell the excess equipment resulting from the completion of large projects, and that could not be sold profitably through the normal used equipment channels. "Auction sales by distributors and large contracting firms are indications of depressed market conditions and may establish a trend for the disposal of used machines in the future."[1]

Comparison of Distribution Methods

Concern here is for the variations of rental-leasing vis a vis the outright or financed sale. The following table will help distinguish some characteristics of the construction equipment distribution methods.

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[1] *Ibid*.

TABLE 3

Marketing Conditions and Practices Prevalent in the Construction Equipment Industry

Characteristics	Straight Lease	Rental-Purchase	Rental	Sale
Maintenance included in payments	No	Seldom	Sometimes	No
Open for inspection by seller	Yes	Yes	Yes	No
Seller controls hours of use	No	Yes	Yes	No
Easy repossession	Yes	Yes	Yes	No
Close distributor-contractor relations	No	Yes	Yes	No
Seller replaces obsolete equipment	No	No	Yes	No
Average life of contract, in years	3	1.3	.5	3
Seller is sure of receiving payments	Yes	Usually	Usually	Yes
Rate of interest on contract	6% add-on	5% compound	7% simple	5% compound
Date of significant beginning	1954	1922	1920	----

Importance of Construction Equipment Marketing

Construction equipment marketing represents an important segment of the total industrial marketing effort with a type of durable good in a price range that would make some of the derived results applicable to other industries.

In relation to the total industrial market of an estimated

$250 billion in 1959, construction equipment accounted for slightly less than one-hundredth of the total market. The price range of the equipment sold may be from a hose clamp selling for a few dollars to a dragline excavator valued at over $100,000. Some of the results of this study may be applicable to other industrial marketing areas for some of the same products and conditions are found in other industries. For example, the construction equipment industry uses fork-lift trucks as does the materials handling equipment industry, which was one of the first industries to use true leasing.

The construction equipment industry was picked because it has been mentioned by many authors as being one of the most prominent in leasing. "The construction industry (including road-building) was among the 10 leading industries using leased equipment in 1958."[1] It is active in rental-lease marketing and will thus be a source of facts and opinions about the features, advantages, and disadvantages of this type of program.

All types of leasing and rental activity are found to some degree in construction equipment marketing. Any comparison between the true lease, the short-term rental, and the rental-purchase plan (where the customer may buy the item depending

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[1] Robert Sheridan, "Questions I'm Asked about Equipment Leasing," Contractors and Engineers (April, 1959), p. 2.

on favorable contracts, service, and use he may receive from the machine), will make a valuable contribution. The writer will also examine the effects of the variations of renting and leasing, and the extent to which each is found within this industry. Thus, while this paper is concerned in part with the finance lease, this study of the construction equipment industry will quantify some of the effects of all rental-leasing.

Construction equipment marketing utilizes channels of distribution similar to those found in other heavy goods industries. Most of the equipment passes through the following channel: Manufacturer---distributor---user, but some companies such as John Deere, have their own channel: Manufacturer---branch warehouse---dealer---user. By using this industry, many of the specific findings will have application to other heavy goods industries with more validity than if a specialized industry, such as farm implements or office equipment, was used since the channels are more representative and the contracts do not have as many atypical clauses. In addition, the construction equipment industry was used because:

1. Many different types of the straight leasing plans are practiced:

    a. Yale and Towne, and Clark have their own leasing subsidiaries,

b. John Deere has a direct contract with the D. P. Boothe Leasing Company,

c. Some distributors have their own leasing subsidiaries.

2. An extensive survey of the industry could be made through the Associated Equipment Distributors so that complete coverage of a large portion of total industry sales was possible.

Conditions for the Growth of Rental-Leasing

Two factors contributed materially to the growth of the rental and rental-purchase business in the construction equipment industry. These factors are:

1. The cyclical and seasonal use of machines by the contractors--new construction starts are at the mercy of appropriation cuts by the government and curtailed plans for expansion by private industry. Uncertain future work reflects in the limited purchase plans by the contractor. Not needing equipment continuously, the contractor rents during the short period of use.

2. The practice of contractor-to-contractor rental--distributors overcame this disadvantage in part by engaging in this business themselves. They have been partially successful in turning this into a profitable

alternative to sale.

Other factors contributing to the growth of rental-leasing but relegated to a secondary level of importance are:

1. Dealer dependency on rentals when equipment could not be sold during the depression era of the 1930's--equipment could not be sold even on the most liberal credit terms.[1]

2. Attention given to renting during World War II--there were many Office of Price Administration hearings.[2]

The Office of Price Administration asked the AED and the Associated General Contractors (AGC) to calculate and publish a recommended procedure for establishing rental rates. Rental activity increased because dealers could not get the equipment to sell. It was a sellers' market so they elected to rent their inventory instead. This gave them a source of income. One interviewee said specifically, "We wanted to rent for we couldn't get replacement inventory."[3]

The conception of finance leasing took place in 1934. The

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[1] F. Babione, op. cit., p. 116.

[2] OPA, Opinions and Decisions, Vol. I (Washington, D.C.: U.S. Government Printing Office, 1943), pp. 193 ff.

[3] Interview with a non-replier to the AED mail survey. Financial information and personal attitudes were asked of the respondents. Anonymity was promised them for obvious reasons. Therefore, all further quotes and references to them will be noted by general description only.

National Recovery Act Code stated that new equipment could not be rented unless the contract provided that the price and a minimum addition of 6% interest be returned within two years. The use made of this plan seemed only sporadic until the trend in finance leasing began in 1954.

The Scope of the Study

This study quantifies the amount of straight leasing done in the United States and intensely reviews the marketing problems of rental-leasing within the construction equipment industry. Several qualifications have been imposed to insure adequate selection and specificity in the major task.

There is no attempt to make a judgment of the effects of leasing on the total economy. The benefits to the population that may accrue when more contractors are able to use equipment without investment are not analyzed. However, some general changes in the attitudes of people during this historical evolution of rental-leasing are noted.

While leasing contains financial considerations as well as marketing implications, the lease can be more clearly examined here by assuming the financial aspects are constant. Many methods of interest computation have been recommended, e.g., those by Gant, Griesinger, and Vancil with his Basic Interest Rate (BIR). This aspect of the lease has received much scrutiny while the marketing side of leasing has been neglected. As evidence that the lease can be treated from two diverse viewpoints, one can review a major work written by two professors, one a finance economist and the other a marketer.[1]

Legal and tax considerations also have an effect upon the use of the lease, but they will be subsumed to another category of review. The marketing structure and the attitudes of distributors toward rental-leasing are the main objects of this investigation. Other conditions are mentioned, but marketing problems such as competitive effects, obsolescence, risk, and policy adjustment will be the primary targets of inquiry.

The demand for construction equipment is a "derived demand." Because the equipment is durable, it is subject to the "accelerator effect." With a slight cutback in appropriations for construction, contractors will use their machines longer and refrain from buying equipment. The construction equipment industry, therefore, suffers a larger cyclical fall in sales than the proportionate fall in construction spending. While this would be an enticing field for suppositions, other factors that bear more directly on this study will be treated.

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[1] W. Eiteman and C. Davisson, The Lease as a Financing and Selling Device (Ann Arbor, Michigan: Bureau of Business Research, University of Michigan, 1951).

Attention is directed at the AED members, to the partial exclusion of the manufacturers. Contractors are later brought into the study because they are the major portion of the distributors' market and permit a comparison of the two transactors--the lessor and the lessee.

CHAPTER II

THE DESIGN OF THE STUDY

The Problem Defined and its Significance

Is rental-leasing as effective as outright selling from the viewpoint of being a promotable and profitable distribution method? This investigation determines if marketing effort has a relationship to the volume of rental-leasing and if the alternatives to purchase can contribute as much to profits as do outright sales. A check is made to see if construction equipment distributors allocate marketing effort in relation to the profitability of the distribution methods. A test is then designed to reveal if placing marketing effort on the profitable methods of marketing significantly increases the profit position of the firm.

Profits and sales are important concerns of marketing. Knowing the effect of rental-leasing on sales and profits, will aid in giving direction for marketing adjustments.

A preliminary investigation revealed that the variations of renting and leasing by distributors in the construction equipment industry are similar to those found in some other industrial marketing areas and, therefore, will provide general assistance in a more complete application of renting and leasing.

Hypotheses of the Study

Four hypotheses were formulated from the key issue of the contributions to profits and sales by the alternatives to purchase. In setting up the hypotheses, the following criteria were used:

-They must be testable, that is, an analysis of the data yielded in the study should provide inferential proof or disproof of them,

-They must have marketing importance,

-They must have commercial significance to the construction equipment industry and, hopefully, be applicable to other industries that lease.

From the review of the literature, four hypotheses seemed most fruitful for testing. Some leasing articles and advertisements have created the impression that leasing makes up a large percentage of total distribution and that the leasing advantages are being used as principal sales ideas. In addition, the distinction is not always clear as to what form of leasing is being evaluated. With this in mind, the following hypotheses are offered about marketing through construction equipment distributors:

1. There is a close relation between the marketing effort for rental-leasing and its percentage of total sales. The percentage of the amount of rental-leasing to total sales is compared to the percentage of marketing effort that is devoted

to encouraging rental-leasing business. This illustrates whether the distributors solicit for this business or whether the volume of rental-leasing is the result of random factors.

2. The greatest marketing efforts are directed at those methods of distribution that earn the highest profits. Do distributors place their efforts according to the profits as a percentage of sales? They are asked to rank the relative profitability of the distribution methods and to rank the relative amount of marketing effort placed upon each method. The investigator does not presume that any specific ranking of the profits will give the largest total profit. It may, however, be best for the firms if they put their greatest marketing effort on those methods that produce the highest profits as a percentage of sales. The qualifications of using profits as a percentage of sales are considered in the final analysis.

3. Straight leasing is not promoted as a primary marketing method. If it were promoted "primarily," it would be mentioned often in sales presentations, sales promotions, and advertising. However, distributors do not often direct customer attention and inquiry to this rental-leasing variation.

4. Straight leasing does not account for a large portion of equipment distribution. Many outside of the construction equipment industry might assume that leasing accounts for at

least half of the construction equipment that is distributed. In contrast the figures will reveal later that true leasing is responsible for less than 5% of the total equipment market.

Literature Support for the Hypotheses

The literature qualitatively supports the hypotheses about construction equipment. Illustratively, writers reveal that: (1) Lessors contend they must lease to meet competition. (2) Those companies large enough to afford major purchases on a direct sale do not use leasing as a rule. (3) Most lessors raise their prices to cover the cost of operations in a secondary market. (4) A majority of Clark Equipment leases are with the purchase option. (5) Some do not think they will ever lease equipment. (6) Marketing effort is occasionally directed by emotion. (7) Leasing promotion brought additional "sales" and profits. Similar views are available from other industries to reveal the circumstances of rental-leasing.

An independent survey of construction contractors by Construction Equipment magazine furnishes valuable data for comparisons. Statistics on the volume of leasing, although scattered, are later synthesized to relate the portion of "sales" in the form of rental-leasing.

Relation of the Hypotheses to the Research

A literature review led to the establishment of the hypotheses. Data needed for testing these hypotheses were the types that could be freely and accurately requisitioned by a questionnaire. The examination of the pretest led to the removal of leading questions and those with answers of insignificant differences. The hypotheses were tested by the statistical analysis of the answers to the final questionnaire. Additional literature analysis and personal interviews augmented the findings and served as an added verification.

Methods and Techniques of Analysis

The four hypotheses were tested by a series of answers on the final questionnaires. These questionnaires were mailed to 201 construction equipment distributors throughout the United States. The distributors were chosen from the AED, 1960-61 Industry Directory,[1] according to a table of random numbers. When the questionnaires returned, the envelope postmarks were attached to the questionnaires so that the geographic representation of this sample could be compared

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[1]This directory lists companies, their officers, and the types of equipment rented. Mr. L. Minor Doolin, an AED past-president who knows many of the members, indicated that officer in each company who would know and respond about the desired information.

with the other surveys mentioned later in the thesis.

The empirical investigation involving the questionnaire survey mentioned above centered on determining the current and future practices of rental-leasing in the construction equipment industry and the opinions of responsible executives as to the relative merits of the alternatives to purchase. Some of these executives were asked to review selected conclusions and their comments were useful in obtaining accuracy.

Historical Method

The literature coverage assisted this study by presenting data to: (1) trace the chronological evolution of renting and leasing, (2) formulate the hypotheses for this study, and (3) interpret the findings of the questionnaire and interview survey. Approximately 50% of this paper is composed from the evaluation of secondary data. The advantages and disadvantages of rental-leasing are evaluated. The differences of opinion are often very great. One example might serve to illustrate these differences. Karl MacDonald of Industrial Acceptance Corporation reviews articles such as those by Robert Sheridan of Nationwide Leasing Corporation and states, "It seems to me that, in many ways, the benefits of leasing are more imagined than real."[1]

[1] K. MacDonald, "Is the Leasing Boom Healthy," Construction Equipment (unpublished galley, 1961), p. 1.

The research methodology of an empirical study in the airline industry has given an excellent format-procedure for this intensive examination of leasing in a specific industry.[1]

Equipment leasing will be traced briefly from its conception until 1950. This will be useful mostly for bringing out different interpretations of historical facts, other than those mentioned by Francis Babione in his "Marketing Equipment by Leasing," Ph.D. dissertation, 1949. The main emphasis of the literature analysis and statistical trends will be on the period following 1950. Tables will be used to show the amounts of leasing being done in proportion to total construction equipment sales. With the statistics gathered, least square trend line forecasting is used to project the possible future volume of rental-leasing as modified by changing trends.

Inferential Procedure

There were a number of precedent factors that led the investigator to believe that the return would be about 40%, or 80 respondents. This forecasted return percentage was based on several factors: the AED forms a common bond for a universal

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[1] Richard Vancil, "Lease Financing of Airline Equipment" (unpublished D.B.A. dissertation, Graduate School of Business Administration, Harvard University, 1960), p. 14.

appeal; most of the members know Dr. W. J. E. Crissy, the chairman; the cover letter was reproduced on the autotype; the questionnaire was designed for them and kept to two mimeographed pages; the AED received a 44% return from these distributors on more detailed questions; and a second follow-up letter and questionnaire were sent to some non-repliers.

The required sample size was determined so that adequate tests could be made. Then, the required mailing was computed based on expected returns. The questions contained in the final questionnaire allowed persons to insert other statements that they held to be more indicative of their personal choice. Although few elected to fill in other answers, those furnished were helpful. The subjective opinions and personal contributions helped present a complete picture.

Each hypothesis was checked by the use of two or more questions. These questions and a number of others that furnished data on the facets of rental-leasing were checked by using the appropriate significance tests.

The Pretest Questionnaire and Preliminary Findings

The answers to the pretest questionnaire of this study, shown in Appendix I, revealed a number of uncertainties and the lack of adequate, circulated information about the straight lease. For example, question 17 illustrates tax uncertainties and question 20 shows that sales contracts are difficult to understand.

Question 23 has predominant answers in 1, 2, and 7 which indicate that future middleman elimination may be the most serious concern of those leasing through a separate company.

The pretest guided the format of the final questionnaire. The questions were spaced out, directions were made clearer, and some questions were reworded.

Sample Size and Reliability

The number of questionnaire returns permitted analysis at the 5% level of confidence. The sample size necessary was determined from a standard formula and table.[1] As a further check on the representativeness of the sample, the characteristics as given by the respondents were compared with the characteristics of the population of distributors. These population figures were taken from the AED, Cost of Doing Business, 1960 survey. The AED survey is composed of financial data asked of all its members. In 1960, 44.8% of the members participated.

Identical questions of profit as a percent of sales and total sales were asked in both surveys. In order to aid the

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[1] John Alevizo, Marketing Research (Englewood Cliffs, New Jersey: Prentice-Hall, 1959), p. 166.

thesis respondents in using the correct figures for their firms, they were directed to the appropriate page in the Cost of Doing Business where they probably recorded their results. Page 23 has a space for their sales and profits. When these were received, they were compared with the median sales and profits for all distributors found on other pages of the AED survey. Using the Normal Approximation to a Binomial significance test, the firm sales and profits were compared with the medians. These comparisons gave opportunity to check the sample statistics with the given population statistics to see if there were any significant differences at the 5% level of confidence. This level of confidence to determine significance is used throughout the thesis.

Practical Questions for Examination

The following questions are listed because they are important additional contributions to the understanding of the marketing implications of rental-leasing. They will be answered in the summary chapter. The questions are:

1. Are the distinctions made in rental-leasing of only theoretical consequence?
2. Does straight leasing increase the total market for industrial equipment?

3. Do the rental plans lead to an over-extension of free maintenance and service?

4. Does rental-leasing require a different marketing mix?

5. Has leasing in the construction equipment industry grown as fast as straight leasing in all industries?

CHAPTER III

IMPLICATIONS OF CONSTRUCTION EQUIPMENT RENTAL-LEASING

As noted in Chapter One, the construction equipment industry has some rental-leasing and marketing practices in common with other industries. Not all of the variations of rental-leasing are used to a great extent by the distributors. For example, while historically being one of the oldest rental industries, it is a comparative newcomer to the field of long-term finance leasing. It "is a relatively new development in the construction equipment industry and has had limited application to date."[1] Some marketing implications of straight finance leasing are inspected in the literature of other industries. Some of the conditions, such as tax procedures, legal provisions, and financial requirements will be similar to those operating in other industries. The implications which are less clearly defined, will be inferred so that the possible effect upon construction equipment marketing can be visualized.

The implications differ depending on the variation of rental-leasing which is most utilized by the distributor. The

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[1]Letter from Mr. P. D. Hermann, Executive Secretary, Associated Equipment Distributors; Chicago, Illinois, November 16, 1960.

competitive forces acting upon marketing when using the alternatives to purchase can be understood more fully when the variations of rental-leasing are distinctly presented.

Variations of Rental and Leasing Operations

Some variation characteristics of rental-leasing were enumerated in the first chapter. These will now be expanded to show some distinct uses and facets of each variation. Practice varies through a wide range, so it was thought desirable by many construction equipment affiliates that a study should distinguish the areas. Briefly, the variations are:

1. Rental. The transfer of the equipment is usually for short durations, one year or less. It is often of "used" equipment. Most of the construction equipment distributors view rentals as a way to use the "trade-in" equipment in a profitable manner, although some distributors build their whole business around renting. The costs and terms of the rental agreements have been structured for this activity and have been practiced for a long period in this industry. The typical attitude toward rentals can be reflected by the following quotation.

> We fought clear of rental business except on compressors as far as any new equipment is concerned . . . also [sic] very little rental business on excellent rebuilt machines.

> Our rental business has been about 95% on used equipment that was sitting in our yard anyway and where we could get a month's rent in advance and have the customer where we either collected rent when due or the machine quit working . . . most of this on very marginal credit risks and therefore calculated risks as to their payment ability and the ability of the machinery to stay in running condition.[1]

2. Rental-Purchase. The contractor may like a given piece of equipment. However, he may be doubtful of whether it will accomplish his particular task or be useful a sufficient amount of time to justify its purchase. In such a case, he may ask for a rental-purchase plan.

The rental-purchase plan requires a product that will "sell itself" once it has been utilized. The sales interview is completed and the brilliant sales presentation fades into the background as the product is put to use to prove its value. Should it be profitable in operation, it will support what has been said about it. If not, it will be returned. The product must do exactly for the customer what the salesman mentioned. Must it be more rational and less psychological in purpose? Not necessarily, as long as the desire for the product continues. Even though a clamshell crane has only marginal profitable value to a contractor, if it gives him the prestige feeling of "owning his own rig," it can be later sold

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[1]Personal letter accompanying the questionnaire from a Montana equipment distributor, May, 1961. Respondents were promised anonymity.

successfully. However, it seems more reasonable to suppose that the equipment must give practical use up to full expectation and be a trouble-free product commensurate with the demands upon it. Therefore, under the rental-purchase type of agreement, the goods should serve a useful purpose and be of high quality. Equipment that would not be tried if it had to be purchased would perhaps now be utilized to see if the results would make it a worthy investment. An advantage of this method is that it affords the distributor opportunity for personal contacts and thus he may be able to utilize the rental-purchase contract as a means for selling his full product line.

3. Straight leasing. This variation of rental-leasing is for an extended period of time (two years or more). It allows the lessee to "expense" his lease payments. The seller can use this as a sales device by pointing out the tax benefit in a sales interview.

This benefit of leasing has chief appeal to the lessee in terms of: (1) postponing taxes, (2) conserving working capital, and (3) making payments easier.

No two distributors have the same profit potentials through the variations of rental-leasing. The situation facing the distributors may govern which of the variations he is likely to stress; for example, with inventory at a high level, he may wish to derive some rental income. If he is without used equipment, he might stress leasing.

More specific insight is given when examination is made of the indigenous factors of construction equipment distribution.

Indigenous Factors of Construction Equipment Marketing

Renting has been commonplace in the construction equipment industry for thirty years. The opportunity to rent from a distributor came largely from a practice of contractor-to-contractor rentals. This forced dealers to make some tactical changes in their programs to meet this inroad to competition. Many felt that rentals would allow persons to enter the industry who did not have the financial backbone or prowess to make a success of it. Entry into the business would be too easy. This would cause anxiety to the contractors who otherwise would have a large enough volume of business to operate on a low profit percentage of the contract price. An AED member suggested, "some of these contractors bid at a low price and then expect us to help them with equipment so that they can make a profit." Distributors voice concern. They wish to build customers of the type that will remain in business, make a profit, and later buy or lease additional equipment. It costs a great deal of money to impress favorably a new customer, establish a credit line, and culminate a transaction. Many distributors are also conscious of the contractors' concern about these "shoestring operators." Edward Weilepp, editor of Kansas Construction magazine, told a group of Kansas Equipment Distributors that the contractors are concerned primarily about "lower equipment prices to these government units, sales of too cheaply priced equipment to 'incompetent' contractors . . . and manufacturer lease plans."[1] Michael Spronck, editor-in-chief of Construction Equipment magazine, wrote in a letter to this writer, "I have found that within the construction industry that there are some contractors who are opposed to leasing. The point is, that there are contractors who as a general practice buy their equipment (on a cash or financed basis), and resent the fact that some "shoestring" or "fly-by-night" outfits are put into the construction business through too loose and too generous leasing programs of equipment distributors or manufacturers." Some are attempting to bring pressure to bear on the dealers and manufacturers by threatening to boycott their equipment lines.

Mr. Spronck in an interview in New York City, made another observation about contractor-to-contractor renting. He suggested that "much of the subcontracting that is done today

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[1] "Editor Tells Kansas Dealers about Complaints," Construction Equipment News (November, 1960), p. 31.

is nothing more than part of the rental program. The general contractor is not looking for the talent." He is just obtaining the equipment that is accompanied by an operator. "It gives him the chance to take bigger, more profitable jobs and expand his operation."[1] If we include a high portion of sub-contracting in the total amount of rental-leasing, it might amount to about 8% of the total annual construction costs. This would have been 8% of $56,233,000,000 in 1959, which is $4.5 billion. This figure at best is an estimate. It is noted that much of the renting from contractor-to-contractor is not reflected in national figures and in many instances may not even be recorded by the companies on their books. The arrangements can be spontaneous, informal, and verbal. Spronck estimated close to 50% of the total rentals in the construction equipment industry are by contractors to contractors. It appears that most of this renting is done for convenience and accommodation, and for short periods of time.

In a personal interview, a Michigan distributor stated that heavy equipment, such as a crawler mounted power shovel with a two cubic yard bucket, would seldom be rented for less than six months. If a contractor needs one for a shorter period, he may resort to contractor-to-contractor rental.

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[1] Interview with Michael Spronck, Editor, <u>Construction Equipment</u> magazine, in New York City, April 15, 1961.

The Associated General Contractors of America, Inc. (AGC) in their manual, warn:

> This [rental] business has its own peculiar risks, and intangible costs which one without special experience is likely to underestimate. Determination of rates for such a business does not involve questions of construction service and can probably be discussed best by specialists in the renting business. Unless a properly drawn lease is used for the renting of equipment, a number of misunderstandings are liable to arise and cloud the transactions. Some of these may pertain to payment of freight, duration of the rental period, liability of the parties, terms of payments, and other matters that can cause trouble when not clearly defined.[1]

The AGC has developed and approved a form of lease called the AGC Equipment Rental Agreement.[2] A contractor might possibly rent a dragline excavator to be operated by his own workers; however, the probability is greater that he will want the equipment supplied with a qualified operator at an hourly rate that will cover all of the costs. It is usually to the benefit of both contractors if the rental rate includes the operator. The lessor knows that the equipment is being run by a qualified, reliable, and trained person who usually operates that piece of equipment and may have some pride in it. He takes care of it, if only because he hates to be bothered by having to work on something less desirable and

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[1] Contractors' Equipment-Ownership Expense, Associated General Contractors of America, Inc. (4th ed., 1956), pp. 3, 4.

[2] Ibid.

dislikes to face the foreman with another problem. The lessee contractor gets almost immediate production after the equipment is positioned with proper instructions to the operator. The renting of construction equipment is a vital function for the stability of many contractors. "Business failures in the industry would surely increase if contractors could not supplement income from construction work, with rental incomes."[1]

Some contractors use the renting out of equipment as a secondary profit center or as a means of making payments for the equipment. Some manufacturers and distributors have withheld the promotion of their rental activity when they knew it would make the contractors' equipment idle. They did not wish to interfere with established accounts. If it were not for the possibility that a contractor could rent his equipment during the slow season or when he would not be needing it, he might refrain from buying and resort to obtaining his equipment needs by more rental. Mr. Robert Sawyer, sales manager at the John Deere branch distributorship in Lansing appraised the net effect of rental-leasing on the construction equipment market and observed that the increase in sales after equipment trial periods is probably cancelled out by the use of rentals by those who otherwise might purchase.

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[1] F. Babione, "Marketing Equipment by Leasing" (unpublished doctoral dissertation, Department of Business Organization, Ohio State University, 1949), p. 135.

It is important that distributors continue to recognize the financial problems of the contractors, for contractors account for 55% of the distributors' total sales. This is observed in Table 3.

TABLE 3

Analysis of Distributor Sales

Category of Buyer	Percent
Contractors (including producers)	55.0%
Counties	11.3
Industrials, utilities	9.2
Mining and logging	9.7
Municipalities	5.5
State and Federal	5.3
Other	4.0
	100.0%

Source: Associated Equipment Distributors.

Research data are available which break down this 55% segment of the market place, representing purchasers by number of employees and annual purchases. Table 4 shows the breakdown. In this intensive study of 1,239 contractors (in the statistical population of 41,250 contractors), it was deduced that the smaller contractors buy most of the equipment.

TABLE 4

Contractors with Fewer than 50 Employees Do Almost Two-thirds of the Equipment Buying[a]

	Total Employment in Group	Annual Equipment Purchases per Employee	Projected Total Purchases	Percent of Total Purchases	Percent of all Contractors in the 3 Categories of Employment[b]
Up to 49 employees	480,000	$1,340	$643 million	64%	86.7%
50 to 249 employees	550,000	448	246 "	24%	12.2%
250 or more employees	370,000	325	120 "	12%	1.1%
Total	1,400,000		$1,009 "	100%	100.0%

[a]Source: Ross Federal Research Corporation and Construction Equipment Magazine, How to Blueprint the Market for Construction Equipment and Materials (New York: Conover-Mast Publications), p. 3 (reprinted with permission).

[b]Source: County Business Patterns, Part 1, U.S. Summary (Washington, D.C.: U. S. Department of Commerce, 1956).

From the standpoint of marketing effort, the large contractor is still individually more important, although there are relatively fewer of these in number. As a group, they represent only one-eighth of the market for equipment purchased outright and one one-hundredth of the number of contractors.

The larger firms are "more likely to subcontract much of [their] work."[1] The research report which was the source for Table 4, states, in support of this buying phenomenon, that while the small contractor with a work volume of under $100,000 annually owns $15,700 of equipment per $100,000 of volume, the giant contractor with over $10 million of annual volume owns only $1,500 per hundred thousand dollars of volume. Contractors buy annually $189 of equipment for every $1,000 of equipment they own. Contractors replace their equipment more frequently than do the other construction equipment users. The average life of their equipment is five to six years. With annual sales of construction equipment at $1.8 billion, we have an existing capital stock of equipment, at "new value," of about:

$9.9 billion = $1.8 billion X 5.5 years.

In a later interview with Michael Spronck, one of the authors of the cited report, he revised this capital stock value estimate to about $8 billion, based on later investigation. This devaluation was partially due to the decrease in equipment sales during 1960.

The same study brought out other informative aspects.

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[1] Ross Federal Research Corporation and Construction Equipment Magazine, How to Blueprint the Market for Construction Equipment and Materials (New York: Conover-Mast Publications), p. 3. The larger contractors may also be able to utilize their equipment to a fuller extent.

"New equipment is bought mainly for replacement. Some is bought for expansion. The proportions bought for each purpose is not known."[1] Their study is based on the rationale that equipment is _purchased_ for replacement and is determined by the amount of equipment which they now own that is no longer profitable for service.[2]

Distributor Characteristics

The 1,640 construction equipment distributors are served by 400 manufacturers. Most of the dealers represent more than one manufacturer, retain their independence, provide twenty-four hour service, and carry a full stock of replacement parts at an average value of over $136,000.[3] Fifty-five percent of them employ between 8 and 19 persons. At the present time, the market is such that the dealer is able to get quick delivery on almost every type of equipment since the production facilities of the manufacturers are only being utilized at about 60% of their $3 billion annual capacity.

Over 50% of the contracting firms are headed by engineers. Many of the contractors have excellent training and education.

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[1] Ross Federal Research Corp., _op. cit_., p. 4.

[2] _Ibid_.

[3] _Cost of Doing Business_, _op. cit_., p. 58.

This challenges the distributor salesmen to present the best product line and the most profitable method of acquisition. The effective sales approach is based on cost savings and work efficiency. The general building contractors buy on specifications with the help of sub-contractors. "In firms which specialize exclusively in heavy building construction, buying is . . . done through equipment distributors or manufacturers."[1]

Financing Methods

The method by which rental-leasing is financed can be a determining factor in the marketing effort expended and the consequent profitability of this activity. It is, therefore, important that the financial foundations be probed.

Distributor Financed

The distributor plays the key role in arranging the lease and uses his own capital to finance about 50% of the rental-leasing that he undertakes. "He is the adviser, counselor, and often the banker to the contractors and other users in his territory."[2] He plays a large role in "providing

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[1] Industrial Marketing Magazine (ed.), 1959 Market Data and Directory Number (Chicago: Advertising Publications, June 25, 1960), p. 388.

[2] Ibid., p. 207.

machinery for the nation's largest single production activity in the postwar era."[1]

Manufacturers are cognizant of the drain on dealers' capital caused by the financing of rental-leasing so only a few of the manufacturers encourage their dealers to pursue this business. They have given little financing help. In times past, "there (has been) little evidence that many of them are willing or financially able to extend sufficient credit to permit the smaller distributor to expand his rental activities."[2] The notable exception to this viewpoint of dealer financing, is the Euclid Division of General Motors. In fact, many distributors complained that Euclid's credit corporation was "buying business with the abundance of money they could make available through distributors for their equipment."

It is safe to say that it is difficult for a dealer to finance rentals. "Closer examination ... reveals that the typical dealer operated with such limited capital that he cannot maintain the inventory of construction equipment required for a large-scale rental department."[3]

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[1]*Ibid*.

[2]F. Babione, *op.cit*., p. 136

[3]F. Babione, *op.cit*., p. 126

If the dealer is unable to acquire capital from the manufacturer, he is likely to find other sources of capital quite limited.

Relevant facts about dealer financing can be drawn from the annual AED surveys. The "Rental of Equipment Inventory," new and used, as a percent of net sales, dropped from 1.69% in 1958 to 1.07% in 1959. It should be noted that the 1.07% represents the rental income and not the value of the equipment out on rental. Rental income must be adjusted to be comparable to the amount of equipment sold. If the 1.07% was 10% of the equipment value,[1] then the value of the rental equipment as a percent of the total sales is found to be 9.8%.

1.07 = 10% of selling price

$10.7 = 1.07 \times 10$

$10.7 + (100\% - 1.07\%) = 10.7 + 98.93 = 109.6$

$$\frac{10.7}{109.6} = 9.8\%$$

The results of these calculations lead to another estimate of rental volume which is expressed in value of equipment. If the $1.8 billion represents total construction equipment sales, and equipment rentals are 9.8% of this, the value of

[1]Monthly rentals of 10.2% and 9.7% of the new selling prices are commonly found in AED's Compilation of Rental Rates for Construction Equipment (12th edition, 1960), when equipment is too diversified to be placed in categories. Some rates are as low as 5%.

rental equipment owned by distributors is \$176,400,000. The annual distributors' rental income is \$19,260,000 (1.07% X \$1.8 billion).

This information above on 1959, and the calculated results for 1958 are summarized in the following table.

TABLE 5

Rental Activity by Construction Equipment Distributors

	"Rental of Equipment Inventory" as a % of sales	Total annual distributors' rental income	Value of rented out equipment as a % of annual total sales	Value of rented equipment
1958	1.69	\$28,730,000	14.6	\$248,200,000
1959	7.1 / .98[a] 1.07	19,250,000	9.8	176,400,000

[a]"Range of Common Experience" figures represent the range reported by the middle 50% of responding distributors.

The reader is cautioned that these values are estimates based on a projection of a single percentage base. A small change in the percentage will radically change the estimate of the industry volume.

To elaborate further on the value of rented equipment, it can be noted that the middle "50% range of common experience" as cited in the Cost of Doing Business, indicates an upper distributor rental income as high as 7.1% of sales. Calculating this activity by the previous method shows that 41% of the equipment distributed by this "firm" was rental equipment.

Distributors are classified along product and volume lines (small, medium, and large). A dealer is either a tractor or non-tractor distributor. The non-tractor distributors are usually smaller operators in terms of volume ($1,446,713 average), but usually have a higher percent of their sales in rental activity (3.17% compared with .32% for tractor distributors in 1959). The higher percent of rental income may be due to two major considerations: (1) They may desire more rental business, for their products require less "free" maintenance. For example, a diesel engine powered electric plant might not require as much maintenance cost as a Caterpillar D-8 tractor. (2) The price range on the equipment is lower, and with a lower volume of sales to make their profit, they resort to rental activity to produce income at the lesser risk per unit rented. This inference cannot be accepted without noting that the medium volume, non-tractor distributors (sales of $1.1 to $2.1 million annually) do the largest percent (10.26%) of the rental volume.[1] However, this is more understandable when it is

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[1] Cost of Doing Business, op. cit., p. 50. Rental income on "used" equipment.

realized that it requires a substantial inventory to: (1) become known as a "rental house," and (2) be able to spread the risks of loss or damage to the equipment among several units so that losing a unit will not produce calamity for the business. One J. I. Case dealer, no longer in the rental business, reported that he rented a Terratrac to a contractor who later stopped making rental payments. When the dealer went to the site to repossess the crawler, it had disappeared. Sometime later in his search, he noticed a patch of fresh earth on the north side of the lot. Taking one of his other tractors, he dug into the spot. There was his Terratrac! The contractor had covered the evidence. The tenuous nature of the contracting business precludes them from being classified as the best financial risks. Their rate of business failures is about 6% annually.

The distributor plays a different part in the financing of rental-leasing depending on the variation of it. An approximate division of his financing role is shown below.

TABLE 6

Variations of Distributor Rental-Leasing and the Percent Financed with Distributor Funds

Rental	85%
Rental-purchase	40%
Finance lease	05%

About 30%[1] of the distributors have started their own rental-leasing subsidiaries to finance a portion of this activity. The W. W. Williams Company of Columbus, Ohio, is one of those companies. This company is, however, an exception in that they fund a large portion of finance leasing (one-fourth of their total sales). Most other distributors use the subsidiary for only their rental and rental-purchase activity. A subsidiary can be incorporated to reduce the liability of the owners should they suffer heavy losses in the rental business. If the company then becomes bankrupt, the courts cannot attach the debts to the distributorship or the owner. As most distributorships are individual or family affairs, they wish to protect themselves against unlimited liability inherent in partnerships. When distributors do finance rentals, they "raise their prices to cover the cost of financing, operation in a secondary market, and increased selling costs."[2]

Distributor leasing requires either an abundance of dollars or an extensive line of credit. Of course, a dealer could be funding conditional sales contracts, in which case he could "factor" these to release monies for lease contracts. Distributor

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[1]Estimate by Mr. Clarence Griese, Assistant Director of AED Industry Relations, in an interview, March, 1961.

[2]McNab, op. cit., p. 129.

financing provides for the greatest amount of control over and cooperation with the lessee, but it can be the most troublesome if the equipment is not operating properly. In the absence of a third-party, professional lessor as a buffer, when any equipment stops--lease payments may stop.

"The distributor may require the lessee to agree to purchase the equipment for stated option prices at some time during the term of the lease, or at the end of the term."[1] This allows the distributor to be sure that the price will be recovered in full. Should the distributor feel that he does not need this protection, the contractor will buy anyway, or that his bargaining position is not strong enough to demand this provision, an option to purchase may be included. Most construction equipment rentals are written on the typical AED contract and have a purchase option, with the rents applicable toward the sale price on a diminishing scale.

> If purchased within 360 days, 90% of the paid rental to apply on full value or purchase price set out above.
> If purchased within 720 days, 80% of the paid rental to apply on full value or purchase price set out above.
> If purchased after 900 days, none of the rental provided for in the attached contract is to apply on the purchase price set out above.
> If and when this Privilege of Purchase Option is exercised the lessee agrees to either pay the balance in cash, in which event the lessor will execute a bill of sale, or enter into a conditional sales contract or

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[1] C. W. Steadman, "Chattel Leasing - a Vehicle for Capital Expansion," Business Lawyer (American Bar Association, Jan., 1959), p. 523.

> chattel mortgage as lessor may require and upon such terms as may at that time be agreed.[1]

Leasing Company

D. P. Boothe, Jr. was the first to start a diversified leasing company, May, 1952. Deere and Company started their lease plan with the Boothe Leasing Corporation with an announcement on January 26, 1960. "Four thousand John Deere dealers from coast to coast will have this lease program available as an added sales tool. A substantial volume of profitable lease business from this source is anticipated."[2] Leasing through lessor companies in the United States grew to $197 million in 1960, one-third of the total amount of long-term finance leasing ($530 million).[3] These long-term finance leasing figures do not include railroad rolling stock, cars, trucks, or equipment from International Business Machines Corporation and other companies with "operational rental plans." Reasons for excluding the last group are: (1) company

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[1]This is a portion of the typical Associated Equipment Distributors Contract. The AED will send samples of the contract to their members who request them. They mention in the cover letter that, "if your attorney should advise you that these forms are acceptable for your purposes in the states where you sell or lease equipment they may be ordered from Von Hoffman Press, Inc., in St. Louis, Missouri."

[2]1959 Annual Report, Boothe Leasing Corporation.

[3]Arnold W. Rodin, "No Slowdown in Leasing Industry; Volume Jumps to $530 Million in 1960" (Chicago: Imberman and DeForest, Public Relations Firm for Nationwide Leasing, Dec. 15, 1960), p. 1.

financial reports do not separate satisfactorily the rentals from the payments for services, and (2) the merchandise can be traded in for new equipment when it is superseded.

There are two primary types of leasing operations carried on by leasing companies. The first is direct leasing. A business wishes to obtain some equipment, so instead of purchasing it, it investigates leasing benefits and arranges to see one of the 50 or more leasing companies. The other type of leasing through professional lessors is merchandise-leasing. These are the pre-arranged programs between the professional leasing companies and manufacturers or distributor organizations. To indicate the importance of the latter type of leasing, the merchandise-lease plans account for about 60% of the volume of Nationwide Leasing Corporation.[1] Deere and Company has this plan with Boothe Leasing Company. It is described below in detail.

Merchandise-Leasing

A manufacturer arranges a leasing program with the leasing company, that will be uniformly used by all of its distributors.

> The leasing company sets up a complete sales training program so that his leasing program will have maximum impact. In merchandising-leasing plans,

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[1] W. Freeman, "Leasing is Found to Expand Sales," New York Times, November 29, 1959, p. 3.

> leasing is used as a primary sales tool, giving the manufacturer's salesmen an important new way to move goods. Not only does this normally enable a manufacturer to increase his sales by the added leasing volume, but the interest generated around the leasing plan results in opening new markets for the product and inevitably results in increased direct sales, often greater than the leasing volume.[1]

The sales assistance received from the lessors is often substantial. They will print brochures for the manufacturer with the equipment and leasing details pictured in an attractive setting. These promotion pieces, usable as either sales aids or mailing stuffers, are generally free to the dealers. Boothe Leasing Corporation sent leasing representatives to most of Deere and Company's distributors, who then explained the program to the sales staff and made some joint calls with Deere salesmen.

A merchandise-leasing plan can be arranged through a number of leasing companies. Programs do, however, vary considerably. KSM Leasing Corporation does not include an option-to-purchase in any of the contracts. KSM will include maintenance, but prefers not to do so. "If we are to include it, the maintenance cost per year would be included in the original invoice cost when figuring the monthly charge."[2]

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[1] R. Sheridan, "Questions I'm Asked about Equipment Leasing," Contractors and Engineers (April, 1959), p. 2.

[2] KSM Leasing Manual and a personal letter from L. S. Clark, Vice-President of KSM, July 13, 1960.

Direct Leasing

Direct leasing (the occasional lease arrangement) still accounts for the greatest volume of business with leasing companies. Manufacturers want to be free to choose the lessor that best fits a particular transaction. In some instances, they could not install a uniform plan for all distributors, for it would meet too much opposition from those who count leasing as an "unnecessary evil." Even without a national plan, distributors can take advantage of this financing method. They can contact the lessor directly when one of their customers is interested in leasing. KSM guarantees not to interfere with normal selling arrangements. "We will contact your customer on a specific lease proposal only at your request or suggestion."[1]

There may be some danger of competitive interference from leasing companies, although there has been no strong evidence of it as yet. James Talcott Leasing Corporation, a company that specializes in financing construction equipment, advertises: "Are you planning to buy more Income Producing Equipment?, 'Talk to Talcott First' . . . About Leasing."[2] These lessors may later, with their large volume of business,

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[1] Ibid.

[2] Wall Street Journal, repeated advertisements.

be able to influence both the seller and the lessee. Nationwide Leasing Corporation, Chicago, intends to buy 15% of Remington Rand's output, excluding the Univac. This purchasing power has the potential of price and bargaining leverage. Automobiles are now purchased by car lessors at $100 more than the dealer's cost.[1] Some distributors hope that similar arrangements will not be made with construction equipment manufacturers.

Manufacturer Leasing

It is worth noting that manufacturers were the originators of the practice of leasing. It was first used only after attempts to sell resulted in failure. This was the last resort! United Shoe Machinery Company found other uses for it quickly. It was found successful for controlling the use of the equipment and the patents. It was a means of controlling the market and then adjusting the effort to it. Another of its advantages was stability of income. In one of the earliest articles treating the marketing aspect of leasing,[2] the stabilized rate of growth and profit for the International Business Machines Corporation and United Shoe Machinery was

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[1] Lee Fleet, Dealer Franchise Plan, Lee Fleet System, Inc., 1958.

[2] R. McNeill, "The Lease as a Marketing Tool," Harvard Business Review (Summer, 1944), p. 419.

traced from 1928 through 1940. During that period, the former derived about one-half of its income from leasing and enjoyed double the annual profits at the end of the analyzed period. United Shoe's profits remained at about the same yearly amount during the 12 years. The writer inspected the gross and net income of these two companies from 1940 to 1959. Most of United Shoe's income during both periods was the result of the leasing program. Gross income grew from $45 million in 1940 to $90 million in 1959. While profits fluctuated during some years, profits averaged about $9 million annually.

Many other manufacturers lease a portion of their output. Pitney-Bowes receives 50% of its income from rent and services, and American Machine and Foundry, 20%. There are some significant differences between the classic "operational" leasing examples and finance leasing. Most of the above companies have relied heavily upon leasing, almost to the point of not wishing to sell any of their products. Finance leasing is just another means of marketing and financing. IBM allows equipment to be "traded in" when the equipment is superseded. Finance leasing requires payment during the whole period: the equipment cannot be returned. In common with the examples given, Caterpillar Tractor, Yale and Towne Manufacturing, and the Clark Equipment Company have experienced growth with leasing revenues.[1] As an example of one type of plan in the construction equipment industry, we can look at the Clark Equipment Company for the effects of leasing on distribution.

Dealer Arranged

The distinction that is being made in the manufacturer leasing plans is one of degree of cooperation and involvement by the distributor, rather than control. The Clark distributors have a financial interest other than receiving the commission checks (which amount to the same as if the sale was cash). The commission comes directly from the Clark Leasing Company, a subsidiary of Clark Equipment. The title is given to the Clark Leasing Company, but the dealer must agree to buy the used Michigan unit (Clark's line of construction equipment machinery) for 5% of the selling price if the contractor does not wish to buy the equipment after the lease.[2] Of course, the contractor is also given the right to renew his lease at reduced percentages of the initial rental fees.

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[1] H. Edelstein, "Growing Trend to Renting vs. Owning Capital Equipment," Magazine of Wall Street (July 6, 1957), p. 454.

[2] "Leasing . . . New Twist in Marketing Grows as it gets Older," Industrial Marketing (February, 1956), p. 57.

About 25% of Clark's business is related to leasing. This does not say that 25% of their "sales" are leases. Many times a contractor can be approached with this idea, and thereby, he may become interested in the product. He may later find that buying outright would be the best in his particular case. Sales are stimulated that otherwise might not have been consummated. Clark estimates that over half of its leasing business comes from customers who have never purchased Clark equipment before.

Some of the switching from a lease to a sale might come about because of the high credit standing necessary for leasing. Without a down payment or lease payments in advance, more is owed to the company; therefore, a higher credit rating is demanded. C. E. Killebrew, Vice President of the construction machinery division of Clark said, "We do not . . . and will not . . . take credit risks that are unwise. In a good many instances we have had to deny their requests because even as good as our plan is, it does not provide a man with more credit backing."[1]

The financial considerations of Clark's plans have concerned a few of its distributors. Some of the complaints have been unusual. One Midwest dealer remarked, "I sell other lines of

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[1] *Ibid.*, p. 56.

equipment. Sometimes when a contractor really needs a larger unit than what Clark offers, he will buy the Clark from me just because the finance rates are so low. This prevents me from selling the type of equipment they should have. I wish Clark would get out of the banking business."[1]

The tone of his voice emphasized his intense dissatisfaction with leasing. The interest rates charged are most reasonable for the straight lease without the option to purchase--slightly over 5% simple interest. The interest rate with the option to buy is 5% higher. Like many construction equipment leasing plans, at least 50% of the price of the equipment must be paid in equal installments during the first year of the lease.[2] Sitting behind his desk, one Clark dealer remarked, with a grumble, "There are no misunderstandings with Clark. We just finance many of the leases of Clark machinery through the bank. The details stay closer to home that way."

Clark Equipment also has a rental subsidiary, the Clark Rental Corporation. The Sales Training Manager in New York said the main distinction between rental and leasing is that "leasing is without maintenance, rental is with maintenance. We rent very little construction equipment mainly because we

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[1] Personal interview, January 20, 1961. Name withheld for obvious reasons.

[2] Bulletin on the Michigan Lease Plan, Clark Equipment.

haven't tapped the market yet."[1]

A sales manual has been designed for a one-hour course to be given to the Clark dealers. Guides to the sales approach are also given.

> The approach will depend of course on the customer and the situation at hand. To a qualified customer who is known to finance most of his equipment, a direct approach could be used. "We can put this machine on your job for $66 a month--no money down." Such an approach would create immediate interest to this class of customer. The direct approach would be unwise in other instances. If the customer is unknown to you and his place of business does not look particularly prosperous, it would be better not to lead directly into financing . . . . In areas where seasonal changes create down time, a (skip payment) contract is actually encouraged. Customers may make as many as four token payments per year (minimum payment is 1.25% of the sales price per month).[2]

The manual further points out to the distributor the advantage of manufacturer leasing:

1. One-stop shopping.
2. Immediate financing.
3. Feeling of continued manufacturer interest.

Clark's construction equipment leasing program has enjoyed success since its conception in 1953. Mr. Kennedy, the Marketing Research Manager at Benton Harbor, said his construction equipment division enjoyed a rise in sales as a result of the leasing program. To get some idea of their increase, the

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[1] Personal interview, Mr. Ted Werner, New York City, May 15, 1961.

[2] J. Tiedge, "A Discussion of Credit and Equipment Financing," Manual for Sales Training School, Construction Machinery Division, Clark Leasing Company.

whole industry should be brought into perspective. Of the $1,866 million construction and mining shipments in 1956, 54% were accounted for by five major producers.

TABLE 7

Total Construction Equipment Sales by the Major Producers, 1956

Caterpillar Tractor Company	$ 585 million
International Harvester	189
Allis-Chalmers Manufacturing	129
Euclid, Division of General Motors	71
Clark Equipment, CE Division	37
	$ 1,011 million

Source: Marketing Research, Clark Equipment, CE Division. Some companies do not report their sales by division, so some figures are estimates.

The above figures were chosen so that some comparison can be made with Clark's activity. In 1958, when total construction equipment sales dropped to $1,400 million (-25% from 1956)[1] and International Harvester's construction equipment sales dropped to $173 million (-8%),[2] Clark construction equipment sales rose to $47 million (+13%). Of Clark's $47 million in sales, $6.7 million was leased, or

[1] Construction and Mining Shipments, Statistical Abstract of the United States (1960), p. 320.

[2] Company report, Standard and Poor's.

12.5% of sales. We cannot attribute this forging ahead in the market to leasing alone for promotional factors also play a part. We can, however, see the effects of favorable marketing plans. At the end of 1958, Clark Equipment had over $8 million of construction equipment on the lease plan. This represented about 19% of the total construction equipment on lease in the United States, which in 1958 was about $42 million.[1] It should be noted that figures on national leasing of construction equipment are not recorded by the government. Figures recorded by private businesses are not standardized. The writer quantified leasing volume, risking the possibility of diverse estimates, so that the relative importance of leasing in this industry can be more clearly visualized.

Clark has an industrious management--from the presidency to the dealer level. "Forbes ranked Clark management highest among 13 major companies in capital goods . . . . When the new Construction Machinery Division found dealers sewed up by rivals, Spatta [the president] would persuade the best salesmen to set up on their own, with Clark's backing."[2]

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[1] "Equipment Leasing Rose During 1959," Michigan Roads and Construction (January 14, 1960), p. 7.

[2] L. Hughes, "George Spatta, Dynamarketer--Clark Pushes up in Four Fields at $208-Million Sales Clip," Sales Management (June 3, 1960), p. 62

Manufacturer Subsidiary

Yale and Towne Manufacturing Company, as Clark Equipment, views the leasing business as an important outlet for new products. Starting out in 1953 on a joint venture with CIT Corporation, the industrial financing subsidiary of CIT Financial Corporation, it gained enough experience to form a leasing subsidiary.

The difference between this organization and Clark Equipment is only slight; therefore, this discussion will be brief. The difference was explained as this. "You can set up a subsidiary, as Yale and Towne has . . . or you can handle it through local representatives, as Clark Equipment Company, Buchanan, Michigan, does."[1] Clark Equipment requires its dealers to arrange the financing details. Yale and Towne has the more centralized operation.

When Yale and Towne first began to lease, CIT men explained the plan to the branches. They, too, were new at this. As a result of the plan, the manufacturer arranged for additional dealers. Because of an extended market, it invested more in sales promotion.[2]

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[1] "Leasing--Its Pros and Cons," Steel (May 29, 1954), p. 6.

[2] "Leasing of Y & T Lift Trucks Hints at New Marketing Trend," Industrial Marketing (March, 1953), p. 166.

In Yale and Towne's leasing guide, the lease is stressed as a "highly valuable merchandising tool." Although the guide states that it is for "companies needing equipment and who are either unable to purchase outright or are simply unwilling to purchase in order to obtain use of the equipment," leases are usually restricted to a three year period. They have lenient financial arrangements and if a favorable Dun and Bradstreet rating is given, "no financial statement or other credit information is necessary."[1] Payments during the lease are sent directly to the subsidiary and other used equipment may also be included in the lease payments. At the end of a lease, the distributor is asked by the manufacturer to sell the equipment if the renewal option has not been exercised. The sales receipt is then shared with this dealer on a 50-50 basis.

Bank Leasing

Banks provide much of the money needed by leasing companies. The Bank of America supplied funds that enabled D. P. Boothe to start the United States Leasing Corporation. Why not lease directly from banks? Many restrictions make it inadvisable for some banks to be lessors. Regulations may prevent them from

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[1] "Terms of Standard Lease Plan," Yale and Towne Manufacturing Company (June, 1960), p. 7.

sharing in the rebate at the end of the lease, which other lenders may receive.[1] Funds may be limited for distribution within a given territory. They may not have the bookkeeping organization to depreciate equipment. They also may not have enough "marketing orientation" to sell lease benefits. However, despite these limitations banks do handle a significant portion of the total volume of leasing.

Banks are often used in leasing because they are convenient to the transaction. They are concerned, however, about owning the equipment with the possible responsibility for maintenance. For this reason, the credit emphasis is placed on the lessee rather than on the manufacturer or on the value of the equipment.[2] Banks wish to be certain that the lessee will not withhold the payments due on faulty equipment.

There are two good reasons for the distributor to use his own bank: (1) the rate of interest is likely to be lower, and (2) he is better known there and so may succeed in having the note processed "without recourse." If the lessor's credit line is fully utilized, it is desirable to try the lessee's bank. Many banks will finance only up to 85% of the value, with

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[1] Gordon Brown, "Role of the Lender in Equipment Leasing," Commercial and Financial Chronicle, Vol. 191 (January 28, 1960), p. 449.

[2] Gant, op. cit., p. 123.

the manufacturer or dealer financing the remaining 15%. "Compensating balance requirements" may lower the actual loan percent of the value to about 65%.

Some lenders may require of the lessor, a chattel mortgage or an assignment of the rent or lease. A recorded mortgage would be valid against "a defaulting lessor."[1] Under such an arrangement the lessee might still retain possession of the leased equipment and pay only the normal rent. An important detail to be remembered about the bank arrangement is this. When safety of the loan is paramount to the bank, bank action similar to "recording the lease," may make the lease a conditional sale, and then related tax advantages are lost.

Finance Company

It was noted previously that a finance company assisted Yale and Towne Manufacturing Company in the conception and initiation of its lease program. Finance companies have supplied funds for most of the straight lease plans. Banks tend to be more conservative about putting money into the relatively new process. Insurance companies are prohibited by many state laws from investing in industrial equipment other than transportation equipment.[2]

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[1] C. W. Steadman, op. cit., p. 547.

[2] Council for Technological Advancement, op. cit., No. 21, p. 17.

Although finance company interest charges average about one percent higher than interest charges of banks, the money is usually more readily available. The process is generally quicker and smoother which is important when a contractor is taking out his first lease. The treatment he receives on his first encounter with leasing is likely to affect his reaction from then on. Distributors or manufacturers can approach the finance companies for special plans. One manufacturer has only his out-of-pocket costs financed and he holds the paper for the balance (profit markup). This way, the interest is only 6%, simple, on the monthly balance.[1]

The largest financers of construction equipment leases are CIT Corporation, James Talcott, Incorporated, and Walter E. Heller. The last two firms have associated leasing companies: James Talcott Leasing and Nationwide Leasing, respectively. The combination of the financing and leasing operations makes the process more integrated and allows a greater concentration of time and effort on the marketing aspects of the plan. The companies have only to obtain the lease business; they have the funds for financing.

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[1]"Machine Tools: Lease or Buy," Business Week, July 24, 1954, p. 88.

Financial Requirements of Leasing

Balance Sheet Changes

One of the strongest appeals made by equipment lessors is "Conserve your Working Capital."[1] If the lessee does conserve working capital, then someone must be putting up sufficient money to finance the cost. The distributor may choose to finance his own "paper." The money may come from internally generated funds. "For the industry as a whole, about 80% of the total 1960 investment will come from such funds."[2] The dealer may supply the funds or he may obtain a general loan against the business. The current assets of the dealer in the former case are depleted and if the contractor's practice is to eliminate the lease as a long-term liability, how may the distributor call it a long-term asset?

The accounting profession has only inferred the correct recording of a rental-lease. When lease payments owed are "material," the footnote should be used to disclose the obligation rather than a formal recording in the body of the balance sheet.[3] Individual contractors and distributors may

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[1]A preliminary content analysis was made of equipment advertisements appearing in five major construction magazines.

[2]D. Keezer, "New Financial Factor Brightens Marketing Outlook," Industrial Marketing (February, 1960), p. 39.

[3]American Institute of Certified Public Accountants, Bulletins 38 and 43 (New York: 1948; 1953), p. 126; p. 291.

vary on what is "material," relevant, or morally correct. Even financial institutions do not thoroughly evaluate lease obligations. Of 512 financial businesses surveyed, intense investigation showed that only a small percent of them used a formal analysis of the lease.[1] Sixty-five percent of the financiers in this corporate survey said that non-cancellable leases allow greater credit than debt financing.

Some interesting changes that affect leasing operations have occurred in the financial picture of the average construction equipment distributor over the last five years (1955-1959).[2] The following changes are noted about the average balance sheet.

Balance Sheet Entry	Percent Change
Notes, leases, and Accounts Receivable- as a percent of assets have gradually fallen from - - - -	33.05 to 30.22
while	
Inventories - have gradually risen from	51.82 to 55.10
and	
Notes Payable - as a percent of Liabilities and Net Worth have gradually risen from - - - - -	24.27 to 31.83

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[1] R. Vancil and R. Anthony, "The Financial Community Looks at Leasing," Harvard Business Review (November-December, 1959), p. 116.

[2] AED, Cost of Doing Business Survey, op. cit., pp. 24-25.

In addition, the "current ratio" of distributors dropped from 1.92 in 1958 to 1.76 in 1959. This is similar to the general decline witnessed by industries. The average ratio for all industries fell from 2.4 to 1.9 in a decade.[1]

Close review of these balance sheet changes above and other data seem to indicate that distributors are financing a smaller percentage of the rental-leasing business while seeking money from various sources to finance a greater inventory for rental activity.

The contractor must also be concerned about his capital position. The "current ratio" is one of his concerns. If the contractor has a large quantity of machinery, which for the most part is still unpaid, his "current ratio" may not be satisfactory to make large contracting "bids." If the contractor is able to rent or lease some of his machinery, the down payment that he normally would pay, remains in his current assets while only the first year's rentals are required to be shown in the *pro forma* balance sheet. With less total liability recognized, the "current ratio" will be much higher.

There are many misconceptions about the balance sheet being a representation of the financial strength of the contractor. Some misconceptions are discussed later. One noted

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[1]Freeman, *loc. cit.*

here is that bondsmen feel that a high cash position helps to insure the carrying out of a contract. However, one AED member took an opposite stand:

> When a contractor owns machinery, he shows a greater intent of carrying out his contract obligation. He has the equipment with which to work, and an obligation to pay for that equipment. This drives him to make the machinery productive and thus provide income for payment.

The Buy or Lease Considerations

Emotional factors enter the buy or lease decision. Contractors, like other businessmen, feel a pride that comes with owning their equipment. These emotions vary in intensity from time to time within each individual, as well as among individuals, making any attempt to weigh this factor very difficult. These emotions guide the philosophy of the customers. After investigation, however, one writer did state: "A very interesting change [is] taking place in our society. No longer is it distasteful to rent."[1]

The rational aspects of the buy or lease decision are easier to quantify. The problem can be looked at from different views:

1. Cost comparison.

2. Working capital and profit analysis.

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[1] McNab, op. cit., p. 135.

The Canadian Association of Equipment Distributors studied the lease-buy decision. They compared finance leasing with buying through a finance company and through a bank.[1] The cumulative cash outlay was planned through a five year period with the income tax considerations included. Canadian distributors pay a 50% tax while larger United States contractors pay 52%. This would give United States contractors a 2% greater tax application advantage to leasing than enjoyed by Canadian lessees. Results of their comparison showed:

1. Finance leasing is useful as tax relief only to the larger contractors (high income tax rate).
2. "The cash outlay is less, through leasing, for a certain period."[2]
3. It is better for contractors to do their "own financing, but for a short term, they are better off to lease because they have less cash outlay and more cash on hand."

Profitability Model

A marketing aid in the form of a model to show profits

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[1] "Comparison of Cost and Cash Outlay When Leasing and Purchasing using Standard Rates for Each Type of Financing," Canadian Association of Equipment Distributors, 1961 Annual Convention, April 25, 1961.

[2] "When to Lease or Not to Lease," Panel discussion, Canadian Association of Equipment Distributors Annual Convention, April 25, 1961.

available through leasing to the contractors would be of assistance to the distributors.

The task here is not to weigh all the decision factors that must be individually examined by each contractor. Nor is this a treatment of the rental or rental-purchase decision. It is realized, however, that factors such as expected period of use, credit position of contractors, and disposition of the dealer towards this activity play decision influencing roles.

Unlike a rental or rental-purchase, the contractor can obtain a finance lease even if the distributor does not offer it. He can go directly to the leasing company, and if the application is approved, the leasing concern will pay the distributor the full amount in cash. It must be mentioned that the receipt of cash is not always so prompt. Mr. Walter Green of Rapids-Standard Conveyor Systems said, "They want the equipment operating satisfactorily before they [the leasing companies] pay out any money. 'Operating satisfactorily' is a relative term. One conveyor was not approved because a box was delivered five degrees off-center. We still do not have our money from that deal."[1]

Many computations for the lease or buy decision have been made. Most of them have not been suitable for presentation in

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[1]Personal interview, Grand Rapids, Michigan, January 10, 1961.

a sales interview. Therefore, the writer computed the figures for a comparison between the finance lease and term purchase. These data are on the following page.

Brief comments should accompany Table 8. The lease and purchase arrangements are compared for a three year payment plan. The interest charge on the lease actually amounts to 18% (6% X 3 years), collected in advance. The rate shown is higher than that charged by some companies. The lease is without option to purchase and meets those conditions that will allow the full lease payment to be an expense for income tax purposes. If no equipment was obtained, the money paid in the model would be profit. Assuming that this contracting firm is a corporation that makes over $25,000 profit a year, or a sole proprietorship or partnership that is in the 52% income tax payment bracket, the firm would pay $20,454 of the $39,334 profit (shown in the model as lease payments) in income tax. Thus, by putting the money in new equipment, the actual cost is only $18,880. The lease can be renewed in the fourth year at 5% of the selling price. The model figures could continue for the full ten years, but the turning point of profitability can be seen after the third year when depreciation allowance continues on the purchased equipment.

The depreciation under the purchase plan is the highest

TABLE 8

Profitability Comparison Model for Leasing vs. Buying Construction Equipment
$100,000 power shovel

Finance Lease (A) 6%/yr. interest, add-on X 3 yrs. = 18%			Purchase on terms (B) 6%/yr. interest on the balance				Comparison (C)	
Year	Annual Payments	(A) Actual Cost After 52% Tax Savings	Total Principal and Interest Payments	Interest and Depreciation[a]	52% Savings on Interest and Depreciation	(B) Actual Cost After Tax Savings	(C) = (B)-(A) Savings on Working Capital	Contractor's Net Earnings on Working Capital @ 17.3%[b] Profit
1	$39,334	18,880	51,467[c]	22,980	11,950	39,517	20,637	3,571
2	39,334	18,880	29,866	19,560	10,171	19,695	815	3,723
3	39,334	18,880	28,266	16,145	8,395	19,871	991	3,875
		56,640				79,083	22,443	11,179
4	5,000[d]	2,400		12,720	6,614	-6,614	-9,014	2,340
5	5,000	2,400		10,910	5,673	-5,673	-8,073	936
		$61,440				$66,796		$14,455
								-$14,455
								Fair market value of used equipment

[a]Sum-of-digits, 10 yr. schedule.

[b]R. Foulke, Twenty-five Years of the 14 Important Ratios, Dun and Bradstreet (1958), p. 60.

[c]Includes $20,000 down payment.

[d]Renewal fee at 5% of list price.

that is normally allowed, without consideration for special depreciation allowances sometimes given contractors on government projects. The depreciation continues after the equipment has been paid for, thereby changing the profit picture as time progresses. The 52% tax saved by applying the depreciation on fourth year profits lessens the "actual" cost of the equipment from the third year value.

The differences in actual costs after tax considerations, shown in comparison (C), allow more working capital to remain within the firm. In the case of contractors, working capital is necessary to meet bid bond requirements. It is recognized that profit is not made on the amount of working capital in the firm but on the amount of profit from completed construction jobs. The working capital ratio to profit is one useful tool for measuring the financial position of a firm. With more working capital, more jobs can be undertaken, and more profit can be made. Contractors average 17.3% net profit after taxes on working capital. Cumulative profit on the additional working capital released over the five year period is $14,455. If the fair market value of the used equipment after this period is less than $14,455, it would be wiser to lease. If the value is more than $14,455, buying would be better.

In the model, only five years are considered. Past the five year period, the tax savings by depreciation on the

purchased equipment reduce the working capital difference, making the purchase the better plan.

Based on outlay cost only, disregarding working capital earnings and value of the used equipment, $22,443 (C) would be saved by using the lease for the first three year period. This is the short-run view only. It can be seen that some assumptions in this model would be unrealistic for many contractors. The model does serve, however, as a guide. When altered for specific situations, it may be conveniently used for explanation in sales interviews with contractors.

In summary, contractors find that leasing equipment is profitable when the need is for only about three years and when they can invest the funds thus conserved at a return of 15% or more.

Non-monetary Considerations

The attitudes of the contractor as well as the distributor are not easily changed. The questionnaire analysis brings some of these distributor attitudes into the open. Attitudes of contractors are not always easy to discover, but some have been mentioned. Some contractors will refrain from leasing and renting even though the cost would be less, just so the practice will not increase and let "unworthy" contractors into the market.

It is difficult to put a "price tag" on the value of ownership pride, but each contractor, consciously or unconsciously, assesses this when he makes the buy or lease decision. This value has often been mentioned as the main deterrent to the growth of rental-leasing.

Tax Aspects of Leasing

Income Tax

Tax Rulings

Tax rulings have not been favorable for the lessees or lessors. Internal Revenue Ruling 55-540 lists six criteria for determining whether a given contract is a legitimate "tax-delaying" lease. Tax-delaying is a correct description, for the taxes have to be paid at the end instead of at the beginning of the lease period. This ruling, in essence, states that if any resemblance to equity is being built-up, the rent is abnormally high, or the exercisable purchase option price is low, the contract will be treated as a sale. Actually, lessors received some benefit from the ruling for it gave them a passage to reprint that seems to have a favorable word for leasing. "A significant motive, may, in some cases, be the tax advantages which might result because of the different timing of deductions for rent as compared to depreciation."

Rulings 55-541 and 55-542 are both lease rulings. Both placed considerable limitations on tax practice with regard to leasing. "Although these rulings provided some guidance to the taxpayer, the criteria contained therein were drawn so narrowly that almost any type of equipment leasing arrangement might be questioned by the IRS."[1]

In Ruling 55-542, a lease with a purchase option was ruled taxable as a sale for the payments were too high for a short period of time, interest was paid on the rental balances, and the assignee was not a business regularly engaged in leasing equipment. This ruling was in spite of the purchase option price being the then depreciated value, which is the fair market value at the end of the lease--a normally accepted price.

Ruling 60-122 of April 4, 1960, has not yet had its full effect on leasing, but its contents are molding lease decisions. It says in part, "Where payments for such use [of the leased equipment] are so arranged as to constitute advance rental, the allowable rental deduction will be determined by apportioning such payments over the term of the lease." This is construed to mean that when a three year lease contains an additional renewal period of three years, even though the

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[1]"Taxation-Leasing," MAPI Bulletin (Washington, D. C.: Council for Technological Advancement, May 19, 1960), No. 3360, p. 5.

rentals of the first period are higher than the second, all payments must be averaged in claiming expense for tax deduction. This virtually forces a renewal of the lease. In the second part of this same ruling, a contract was determined to be a sale. The lease plus the renewals may equal the economic life of the equipment. Again the IRS took the "possible" lease period to be the actual lease period and anticipated the intent of the lessee.

The Tax Courts in considering leases with purchase options weigh answers to two questions:

1. Is the purchase option valid for a much shorter time than the useful property life?
2. Do the rental payments approximate the purchase price?

If the answers to both of these questions are "yes," then the contract is viewed as a sale. However, one company was able to deduct full rentals even though the $100,000 "payments to be made under a five-year lease with an option to purchase were twice the amount ($50,000) for which the lessee could and did purchase the premises at the end of the 5-year term."[1] This lease did not provide for rent to be credited against the purchase price.

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[1]Rent vs. Purchase, 612 Standard Federal Tax Reports (Washington, D. C.: Commerce Clearing House, Inc., 1960).

If the total rental is more than "reasonable" under a purchase option contract, then to avoid giving the idea that equity might be building up, the additional amount over the normal rental could be specified separately as "'Consideration for the option,' the lease making it clear that this additional payment confers no equity in the property."[1] It may be that Clark Leasing Company's brochure stating a 5% higher interest charge for leases with an option to purchase, will satisfy the requirement of this separate payment and make them tax deductible.

Development into a later sale holds little affect on rent deductibility as an expense. "Rental deductions were allowed on machines which [the] taxpayer later purchased."[2] The concern is that the intention to buy was not present at the time of the lease contract.

The intent is not always clearly discernable. "The taxpayer rented equipment for use in his contracting business, usually at a monthly rental of 10% of the list price of the equipment. He retained possession of some of the equipment during the non-working season, at the request of the lessor, without paying rent. Some of the equipment he purchased, applying rental payments to the purchase price." These

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[1] Ibid.

[2] Western Contracting Co. 271 F. 2d 694., 1959.

payments were disallowed as deductions.[1] As the intent is so important, the writer suggests typing on the contract form--"The intent is to rent. The purchase option will be exercised only if the situation changes."

If the equipment is to be rented at daily or weekly rates based on production, use, or mileage not directly related to price and the purchase option would be exercised at the fair market value at the date of purchase; then it would usually be considered a lease by the government.

Considerations Supporting Tax Exemption

No one group of measures taken can insure that contractor lease payments will ultimately be classified as an expense in the tax courts. It is advisable to note that a Pre-clearance with the Internal Revenue Bureau will save many headaches. Just a brief word about this procedure. When a distributor decides what types of lease arrangements are most desired by his contractors, he should then determine what arrangements are most compatible with his own needs and requirements. A standard lease form can be drawn up with the aid of his lawyer, perhaps using the AED form as a guide. This should be submitted to: Lease Pre-clearance Section, Internal Revenue

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[1] Abramson v. U.S., 133 Fed. Supplement 677, 1955.

Bureau, Washington 25, D. C. Instructions are in Revenue Ruling 54-572. While this precaution will not guarantee that all future leases will be treated as expenses, because the courts reserve the right to interpret the rulings and code, the IRS is closest to the intent and interpretation of the law.

Considerations to be included in the preparation of the contract are:

1. No purchase option. This is discussed in another section of this study. It should be here noted that the purchase option usually classifies the lease as a "sale." If it is a sale, the depreciation rates, not the lease payments, are the expense items for tax purposes. If the purchase option *must* be used, certain precautions might help. The buying price at some future date should be the fair market value at the time the final sale takes place. This might be determined later by an average of three estimates of its value. If the *intent* to buy is indicated, as opposed to only showing the possibility that this may become a sale later, then the tax courts will treat it as a sale. Any indication that equity is being built up by the contractor will cause the Internal Revenue Service to disallow the expense. This is spelled out in the Revenue Code.[1]

[1] Section 162 (a) and (e), Internal Revenue Code, 1954.

2. <u>The rentals should approximate the amount of possible depreciation</u>. Some use the guide of 10% either above or below the depreciation rate as permissible for the amount of the rent that can be classified as an expense.

3. <u>The lessor should pay the insurance, maintenance, taxes, and other expenses that can be estimated properly</u>. By doing this, the lessee does not care for the equipment as if he were the owner, and the courts get the impression that he is not buying. It is noted, however, that few finance leases are arranged in this manner.

4. <u>Renewal rates should provide a substantial return for the lessor</u>. If the rates are too low, it would seem that they are only paid to have some evidence of a lease after the full price has been received.

5. <u>The lease should not be recorded nor allude to bankruptcy law protection</u>. These only strengthen the belief that a conditional sale has been made and the lessor desires to further insure his repossession rights on the "sold" equipment.

6. <u>Broker the lease through a leasing concern</u>. This is advisable when the difference in cost is negligible. It brings third-party assistance to attest to the lease conditions.

7. <u>Lengthen lease period</u>. The closer it approaches the depreciation period of the equipment, the less the IRS is apt

to view it as an expense-padding vehicle. "Some acceleration of lease payments would seem to be quite proper because leased equipment usually depreciates faster than owned equipment."[1]

A Surface Combustion Company (furnace and air-conditioning industry) spokesman[2] voiced this word of caution. "We have analyzed a number of lease agreements of other companies and find that two-thirds fail to be leases if placed under close scrutiny by the IRS." This can cause confusion dangerous to the good will of customers. Clark Equipment is now experiencing some of this controversy. If the lease is "titular," that is, treated as a conditional sale by the IRS, customers who leased mainly because of tax advantages will be sorely displeased.

State Tax

Many states have personal property and sales taxes. Usually states are not as interested in who pays the taxes as they are in that they get paid. Some states, such as Ohio, fix an extra property tax upon items that are leased by lessors of another state. This is a penalty upon those who use the

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[1]F. Griesinger, "Decisions to Lease or Buy Equipment Are Made no Easier by New Revenue Rulings," The Journal of Taxation, Vol. 4, No. 3 (March, 1956), p. 3.

[2]John E. Taylor, "Leasing an Industrial Equipment," Toledo, Ohio, p. 26.

lease method of acquiring equipment outside the state.

The credit manager of the John Deere branch office feels that the holder of a rental-purchase contract is subject to double taxation in Michigan. While the payments are being made for the use of the equipment, a "use" tax is paid on the rentals. If the equipment is later purchased, a sales tax is applied on the total price of the equipment. This would make the arrangement expensive and be a strong disadvantage.

The personal property tax issue is of grave concern to the lessor. The AED typical contract spells this in detail. "Nothing in this paragraph is to be construed as meaning that the lessee is to pay the personal property tax levied against the machinery rented when said machinery is delivered within the home state of the lessor, as in this case the lessor is to pay his own personal property tax."[1] This seems to be the best method of handling this problem. The contractor doing business in another state should know more about the legal problems of that state because he must obtain a "permit" to be allowed to start new construction.

Legislative and Judicial Impacts on Leasing

The legal questions involved in leasing are different from those of sales. "Lease liabilities are not debts. They are

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[1] AED, "Terms and Provisions of Lease," printed for members.

not liens on the assets of the corporation because the corporation does not own the leased assets."[1] The liability does not involve all of the contractors assets, but only the particular piece of equipment which could be repossessed by the distributor.

While antitrust action has prevented the distributor from forcing the contractor to operate the equipment at top capacity, which he would like to do if his rate was applicable to production, he can still use the maintenance service as a source of additional income. These rate surcharges for maintenance range from an extremely reasonable amount ($8 a month on a $4,000 piece of equipment) to exorbitant amounts. If the dealer wishes to curtail the leasing practice, he raises the surcharges.

The lessor faces less legal requirements than the seller during repossession. He can avoid the forced sale provisions of the Uniform Conditional Sales Act (Sect. 19) and its recording provisions.[2]

Bonding Requirements

Many projects to be constructed have a <u>bid bond</u> requirement,

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[1] C. W. Steadman, "Chattel Leasing - A Vehicle for Capital Expansion," <u>Business Lawyer</u> (American Bar Association, 1959), p. 547.

[2] Uniform Conditional Sales Act, 5, 10, 14.

i.e., a bond must be obtained before the bid is accepted. A surety company will examine a contractor and attempt to judge whether he is financially sound enough to carry out the project that is being bid upon. The surety companies look to many things in making this judgment. They would like to see a current ratio of 2:1 although they seldom hold to it. Normally they desire the contractor's working capital to be 10% of the value of all contracts they hold including the new bid. Rental and leasing payments during the coming year should be entries under current liabilities, but bondsmen are not investigative on this point. Although they realize that finance leases have non-cancellable terms, they do not always distinguish them.[1] Incomplete investigation of indefinite rental-leasing practices permits a higher working capital position and an opportunity for larger contracts. Without a representative capital position required, contractors resort to more rental-leasing.

Contractors want to conserve cash for specific reasons. In lieu of a bond, they can deposit a certified check for 5% of the engineer's estimate. This insures the owner that he will be able to get the project done for the low bid. This outlay does drain the cash position of the contractor thereby

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[1]Interview with Charles Frey, Bonding Manager; U.S. Fidelity and Guaranty; Lansing, Michigan; April 6, 1961.

making renting and leasing attractive.

The 5% cash deposit is often prohibitive. Thus, maneuvering the financial statements through rental and lease recording may be the only way for a contractor to qualify for the necessary bid bond. The contractors pay for this bond and it is the same cost whether they rent, lease, or buy equipment. Many distributors say that this requirement is one of the reasons why the contractors want to lease. A Connecticut distributor attests that this is the most important factor in the growth of rental-leasing.

Another type of bond that may be of value to the distributor is the contract bond. If a contractor becomes bankrupt or fails to pay, the protection against "mechanics lien" in some states insures payment on leased equipment. "Many states say that equipment or repair parts used on a job, particularly on public works, are lienable. Thus the bonding company is responsible for rental payments and repair parts payments used on a job for which it has made a bond."[1] Required payments do not apply to a regular purchase contract, but will insure payment under a rental-purchase contract that has not converted to a conditional sale.

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[1]"Rental Purchases," Construction Equipment News (November, 1960), p. 11.

There are some who contend that a payment bond should be required of contractors who wish rental contracts. This would insure satisfactory payment or return of the equipment in suitable condition, even if the contract bond did not apply, i.e., the equipment was not designated for a specific project. This bond could be a costly requirement and is not necessary when dealing with reputable contractors. Of course, misunderstandings can distort customer relations even under the best conditions. Loss of some rents, of course, is a risk of this business and must be considered in rate making.

The "reasonableness" of the rental rate is also subject to review by the Internal Revenue Service. In a recent case it was decided that the AGC, Contractor's Equipment-Ownership Expense manual could not be used as a basis for judging the reasonableness of rentals. The government had previously contended that the AED, Rental Rates for Construction Equipment "should not be considered by the court because the rates reflected are 'fantastic.'" In a specific case, J. C. Mitchell, vice president of Euclid-Arkansas, Inc., and others from the industry appearing as witnesses, stated that the rates were reasonable and that the renting of heavy specialized equipment was infrequent during 1952 and 1953, as it was too expensive and too specialized.[1]

[1] Arkhola Sand and Gravel Co. v. U.S., 1523, U.S. Dist. Ct., 1960.

Arkhola rented a $63,415 Cedar Rapids Rock Crusher for "20¢ per cubic yard with no minimum rent." Along with rental of other equipment, it was furnished a $65,000 Bucyrus Erie 54B Shovel "at not additional rental charge."[1] Most of the equipment was used for "the same rental which it had charged since the rate was established in 1937, e.g., 50¢ per cubic yard of concrete produced with no minimum charge." An analysis of this case revealed two important points: (1) If distributors are not mindful, rental rates for continuous use may be maintained at the same level simply by inertia. This would make renting unprofitable during rising price and cost levels. (2) Renting can facilitate flexible operations for the lessee and lessor. The distributor could replace equipment when he had a customer to purchase a certain rented unit. This flexibility can allow both to have equipment ready for use or sale when it is needed.

State Laws

An analysis of all state laws as they affect rental-leasing is not included. An appreciation of some existing differences is necessary to realize that marketing effort in construction equipment leasing must be flexible when applied

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[1] *Ibid*.

to interstate operations. At an AED Management Conference, members discussed this matter. "Each state, they pointed out, has its own laws, which it interprets in its own way. Any attempt to make specific recommendations, the discussion leaders admitted, would be wishful thinking because of this diversity."[1] They advised that leases be drawn to conform with each existing state law.

Examples of interstate differences in legislation affecting rental-leasing would be enlightening. "A Kentucky court ruled that state law does not require the state highway department to rent construction equipment by competitive bidding."[2] The state had to pay the full rent even though another portion of the contract was extralegal. The state of Washington is now trying to enact a bill to license only contractors who are financially capable. This would eliminate fly-by-night operators. A Wisconsin distributor who also operates a branch in Michigan stated: "The state pre-qualification regulations [in Michigan] penalize the legitimate buyer of equipment and favor the operator of leased equipment with easier bonding. In Wisconsin we do not lease [rental-purchase] more than 10% of our sale-lease total. In Michigan we lease 80% of our

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[1] AED, "Rental Purchases," op. cit., p. 11.

[2] "Equipment Rental Legal Even though Work Wasn't," Engineering News-Record (November 19, 1959), p. 130.

sale-lease total."

Bankruptcy Provisions

The law generally favors the rental and rental-purchase agreement, but limits the ability to collect under the finance lease, unless the equipment is necessary for continued operation of sections of the business to keep loss at a minimum and then only on a voluntary basis with the trustee.

First, the bankruptcy provisions affecting renting variations will be discussed. The distributor retains legal title in a rental-purchase agreement until the option is exercised. In case of a default, repossession can take place without going to court. One case gives evidence of this. A distributor rented out a crawler tractor with a purchase option. The contractor later declared bankruptcy. When the distributor showed the contract to the sheriff on the job site, he was permitted to repossess the crawler. Later this right was challenged by both the referee and other creditors, but it was upheld that the agreement was not a sales contract.[1]

The finance lease is treated as neither a rental nor conditional sale. Under the Chandler Act, Chapter X, the dealer may receive three years rental in a reorganization case and

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[1]Case reported in "Rental Purchases," op. cit., p. 11.

one year's rental in a bankruptcy.[1] He does not become a general creditor for the amount of the contract over the repossession value and the required payment.

Recording of Contracts

In most states, leases do not have to be recorded in the county court houses as do mortgage contracts. The W. W. Williams Company of Columbus, Ohio, used the Chattel Lien department of court records to establish its right against other creditors to the ownership of particular machinery. "Some of the W. W. Williams Company customers have objected to the recording of the lien, but the policy is strictly enforced."[2] This company, which has eight years of leasing experience and recently organized the Mid-American Company as a leasing subsidiary, usually leases without the option to purchase. If one is requested, it will treat the lease as a conditional sale. Few states have, to date, instituted a Lease Lien section for recording.

Illegal Clauses

In the discussion of legal aspects of rental-leasing,

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[1] D. Gant, "Illusion in Lease Financing," Harvard Business Review, Vol. 37 (March-April, 1959), p. 124.

[2] McNab, loc. cit., p. 90.

some statements concerning illegal clauses are appropriate. The government places limitations upon the use of some clauses in contracts. The limitations are upon the marketing program of the individual distributor and are for the purpose of protecting the free market. Decisions arising from United Shoe, IBM, and other familiar cases, will not be repeated. It is common knowledge that "tying clauses," sometimes called "tie-in clauses," permit a product to be purchased only when other, perhaps unwanted, products are taken. The "supplies clause" is illegal even if the leased equipment will not give maximum performance when a competitor's supply part is used.

The government through its treatment of the cases shows interest mainly in eliminating the restrictive clauses and preventing monopoly before it starts, when there is evidence of monopoly intention.[1] Examples of restrictions and monopoly intent can be shown by some selected illegal clauses:

> This equipment must be used at full capacity during the time that rents are based on the units of work completed.
>
> A return charge shall be collected when the equipment is given back to the lessor.[2]
>
> The leasing contract is invalid if the user rents other machines from any competing equipment [distributor].

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[1] H. Greenfield and F. Griesinger, op. cit., p. 86.

[2] CTA, op. cit., No. 21, p. 13.

> There is a higher rental charge [exacted from those] who lease other equipment from competing machinery [dealers].[1]

Other legal conditions (consent decrees) that reflect on leasing operations are presented in the next section. Altogether, these have widespread implications on the marketing effort.

Consent Decrees

The classic United Shoe Machinery and IBM consent decrees have been explained extensively in another dissertation.[2] The actual results to the marketing organizations are often different from those intended by the decree. The ultimate effects of such decrees rest with the industrial consumers and follow an acceptable marketing principle--the customers can control the direction of marketing effort by their action in the market place. One writer stated with respect to IBM's 1956 decree, "Many large users of its equipment continue to prefer rental arrangements."[3]

Many companies recently were instructed to sell merchandise

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[1] R. Alexander, et. al., Industrial Marketing (Homewood, Illinois: R. D. Irwin, 1956), p. 249.

[2] Babione, op. cit., p. 303.

[3] "Big Profit from Rental Revenue," Financial World, Vol. 108 (December 11, 1957), p. 10.

rather than offer only to lease. In a consent decree, the government gave American Machine and Foundry five years to introduce a sales plan for its vending machines. The Pinspotter is one of its "most leased" products, but was exempt from this directive. Mr. Carothers,[1] of American Machine and Foundry's Marketing and Planning Division, said the rationale behind the exemption was this. Brunswick offers a comparable pinboy mechanism. Should the customer wish to buy--he goes there, if he wishes to lease--he comes to AMF. With alternatives given for an equally substitutable product, the government feels that the market is given free choice.

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[1]Interview, New York City, May 15, 1961.

CHAPTER IV

SURVEY ANALYSIS OF RENTAL-LEASING

Significance of the Questionnaire and the Sample

It was noted in Chapter II, that a pretest questionnaire was administered to thirty members of the Associated Equipment Distributors. This pretest questionnaire with the summarized answers is found in Appendix I. A number of improvements were made in the form of the questionnaire as a result of the pretest and the intensive review of the required associated data, parts of which are found in Chapter III. Modifications could thus be made in the wording of the questionnaire so that the distributor would understand more clearly what information was desired. Certain questions were designed to elicit attitudes toward the alternatives to purchase. The final questionnaire is reproduced in Appendix II.

The format of the questionnaire and the distinctions drawn among the alternatives to purchase were reviewed with members of the AED Executive Advisory committee. It was hoped that by proceeding in that manner, some of the confusion that at times accompany a mail survey might be eliminated.

The questionnaire was sent to a random sample of AED members in the continental United States. The results of the

mailing were as follows:

Number of questionnaires sent--------	201	
Number of returns--------------------	107	53.5%
Number of tabulated returns[1]---------	100	49.7%
Sample size as a percentage of the population (total distributor membership of AED)---------------		14.3%

The first step taken after the questionnaires were summarized was to determine if the returned questionnaires were typical of the population of AED membership. Typicalness was judged on two important characteristics: 1) sales volume, and 2) profit, as a percentage of sales. The method of applying the test is mentioned in the design of this study, Chapter II.

The sales volumes of the distributorships in the sample were compared with the median sales volume, $1,922,148 for all distributors, as reported in the Cost of Doing Business survey. The differences in sales between the sample and the population were not significant.[2]

The profit, as a percentage of sales for each firm in the sample was compared to the median of 2.25% for all distributors. The differences in profits between the sample and the

[1]Six returns could not be tabulated. One dealer returned the cover letter with the comment, "I am sorry but I'm too busy to look up the figures." Three returns were too contradictory. Two were satisfactory and helpful, but arrived after tabulation. Eight returns included personal letters that gave useful information.

[2]The Normal Approximation to a Binomial test was used at the 5% level of confidence for both the sales and profit differences.

population were not significant.

Additional information was recorded after each questionnaire was returned. The types of equipment rented and the geographic location of each distributor were noted. Similar geographical distribution of the respondents to this questionnaire and the one sent for the AED, Cost of Doing Business suggests that the same population was examined. The AED survey has 14 regions comparable to the 9 divisions within the United States which were used in this study. The following table shows the geographical similarity.

TABLE 9

Comparison of the Geographic Area of the AED Survey with this Study

AED Regions	Divisions Used in Thesis	AED Replies as Percent of Total	Thesis returns as Percent of Total
1,2,3	7	13%	16%
4,6	8	13	17
5	9	8	8
7,8	4	16	22
9	5	10	11
10,13	6	15	9
11	2	8	3
12	1	9	6
14	3	8	8

Source: AED, Cost of Doing Business, pp. 36-39.

In view of the typicalness of the thesis replies as previously noted, and the geographical similarity shown in Table 9,

it is reasonable to apply the results of the mail survey to all of the AED distributors. Before reporting the results of this study, however, it is desirable to contrast some of these answers with answers from a questionnaire mailed to contractors.

The construction industry has been provided with much statistical information to help firms assess the progress being made. Most of these data refer to the amount of construction that has been "put in place" and the dollar gross or number of units of equipment sold. Three questions in the thesis questionnaire were arranged to facilitate the comparison of data from a survey of over 200 contractors. This survey appeared in one of the leading trade publications subscribed to by contractors.[1] Although the survey may present some readership bias, it contains most of the elements of genuine research structure. The researchers, Michael A. Spronck, Editor, and Arthur Dix, Director of Research for Conover-Mast Publications, use prevalent techniques. A review of the national readership shows conformity to the geographic location of the respondents to the thesis questionnaire. There is little reason to doubt that it is a representative sample of the market for equipment among contractors.

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[1]"Lease the Machines You Need Now," Construction Equipment, September, 1958, p. 40. The survey is used with permission.

It is recognized that there are over two years of time between the receipt of these two surveys. In making a judgment about the significance of this time span, two factors should be considered. First, the history of renting in this business has been comparatively long. The procedures have been the result of 30 years of industry experience. There is no reason to believe that practices will radically alter in a short time. The second thought bears a slight difference from the first. Finance leasinghas been recently introduced on an extensive basis in this industry. Therefore, many of the contractors might not have noted the difference in their replies. This is discussed in greater detail when the evaluation of reasons for leasing is undertaken.

The first comparison made with the contractor survey concerns the use of the purchase option. The question asked the contractors is reprinted in Table 10. This is followed by the question asked of the distributors so that the basis for comparison can be clearly seen. This presentation sequence will be used for the other comparisons.

The reader will notice in Table 11 that the thesis replies were grouped into seven categories for comparison of the data in Table 10. This was done by the accepted practice of moving the replied percentage into the nearest category. Similar grouping is also made for Table 13. The data for purchase option comparison are in the following tables.

TABLE 10

Contractors' Use of the Purchase Option

How often do you exercise your purchase option?

100%	22 replies
90%	27
75%	18
50%	26
25%	9
10%	13
0%	6

Question asked of the Distributors

______% of the purchase options are exercised.

TABLE 11

The Use of Purchase Options by Contractors and Distributors

Percentage of the Options Exercised	Contractors Using This Percentage		Distributors Experiencing This Percentage of Usage	Dif-ference
	Number of Replies	Adjusted Percent	Number and Percent	Percent
100%	22	17	16	1
90	27	23	29	6
75	18	15	18	3
50	26	21	22	1
25	9	7	9	2
10	13	11	3	8
0	6	5	3	2
	121	100	100	23

To facilitate comparison, the contractor replies are changed to percentages. All 100 distributors answered this question, so the results are both in number and percentage. A significance test was applied to the average difference of the percentages in Table 11. The same test will be used in the subsequent comparisons. The null hypothesis that there is no significant difference (23) is accepted.[1] Therefore, it can be said that there is conformity in the answers of these two groups. There is similarity in the action of the contractors in the use of the options and the experience of the distributors concerning the purchase options. It is realistic, then, to assume that the contractors' actions are not too variant from the behaviors of other customers on this point. A proper purchase option is, of course, the closest bridge connecting a rental and outright sale. Only the exercise of the option separates the two methods of distributing equipment. There is some indication also, that while the contractor represents only 55% of the distributors' business, the contractor may use the option as the remainder of the buyers do and be representative of the total market in the use of the purchase option.

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[1]The computed Student's T was 1.27; T = 2.44 for the 5% level of confidence with 6 degrees of freedom.

The purchase option is a very important part of the renting business and is a practice of long tradition in the construction equipment industry. Based on this and the lack of significant difference in these replies, there seems to be little change on this point that has taken place in the two years between surveys.

The second comparison that is made with the contractor survey is the forecast plans to lease as opposed to buying during the fiscal year, 1959, with the experience of the distributors in rental-leasing during the fiscal year, 1960. The questions asked in the two surveys are listed, respectively.

TABLE 12

Contractors' Plans To Lease (Rent)

In acquiring equipment this year, what percentage do you plan to lease compared to buy?

Lease vs. buy for new equipment

Portion	Replies
No. Leasing	62
10%	30
25%	26
35%	5
50%	18
75%	3
90%	6
100%	12

Question asked distributors

Total dollars resulting from rental and leasing account for what percentage of your company's sales? 21.6%

TABLE 13

Rental-Lease Portion of Construction Equipment Acquisition

Percentage of Acquisition by Leasing	Contractors Planning To Lease This Percentage	Number of Distributors Who Leased This Percentage	Percent of Contractors' Plans	Percent of Distributors Leasing This Percentage	Difference in Percents
0%	62[a]	19	38	21	17
10	30	23	19	26	7
25	26	25	16	28	12
35	5	5	3	6	3
50	18	13	11	15	4
75	3	1	2	1	1
90	6	2	4	2	2
100	12	1	7	1	6[b]
	162	89	100	100	52

The data were categorized and placed in Table 13 following the same procedures mentioned for Table 11. The test applied to the average difference of percentages showed that significant difference (52) between the two sets of answers exists.

The reader notes that this is a comparison of plans to lease on the part of the contractor with the results of rental-lease experience. There is little similarity between the

expectations and the actual occurrences. One can realize that the use of the purchase option is to cover the uncertainty about the continued utilization of the obtained unit. The privilege of removing anxiety caused by doubt of whether the equipment will be profitable for the firm, costs the contractor approximately 5% more in the rental or carrying cost over what the charges would be for a straight rental.

From (a) in Table 13, one can note that many contractors are able to do business without resorting to rental leasing. They may do rental-leasing only as a last alternative; therefore, they make no plans to engage in it. Distributors may find that they must do a portion of it to meet the demands of some customers. There is little reason to question that even the distributors leasing a high percentage of their business have some customers who do no renting and leasing. Once the distributors engage in the practice of rental-leasing, it is comparatively easy for this method of distribution to rise to the 20% level of total sales. The average renting and leasing volume as a percentage of all of the distributors' sales was 21.6%.

From the lower portion of Table 13, (b), there is an indication that a greater percentage of contractors than distributors rely on renting exclusively. This difference in the percentage between the two answers, along with other disparities, may be

due to large amounts of renting done from other contractors, rather than from the distributors. There would be no reason to assume that the characteristics of length of the contract period, type of contract, and the use of the purchase options as shown in the first comparison table, would be similar to the contractor-distributor arrangements. Few contractors would offer another contractor the option to purchase on a rented item.

It seemed appropriate to compare the reasons why contractors rent and what the distributors view as the reasons why contractors rent or lease. This was a test to see if distributors as a group were able to perceptively determine the motivations that guide the contractors' behavior. The questions asked the contractors and the distributors, respectively, are shown in Tables 14 and 15.

TABLE 14

Contractors' Reasons for Leasing (Renting)

What are your principal reasons for leasing equipment?

67%	Need equipment for short period
50%	Need specialized equipment for one job
40%	Easy way to pay for machine for long term
30%	Able to deduct leasing cost from income tax
25%	Try out machine before buying
12%	No down payment
11%	Minimize maintenance costs
8%	Want to use newest machines in the market

*Total is more than 100% because some respondents checked two or more answers.

TABLE 15

Distributors' Perception of Contractors' Reasons for Rental-Leasing

The one main reason why contractors want to use:		Rental	Rental-Purchase	Finance Lease
Need equipment for a short period	1)	70	1	--
Can pay for machine easier	2)	1	40	12
Deduct payments for income tax	3)	12	11	19
Try equipment before buying	4)	4	12	1
Conserve working capital	5)	6	24	22
Want newest machines	6)	3	8	10
Meet bonding requirements	7)	2	1	3

The question asked the distributors varies slightly. The alternative for a possible reply of "need specialized equipment for one job" was omitted for it was very similar to the one above it. In the interest of brevity, significant difference, and clarity, it was dropped along with the weight assigned to it so that no distortion would arise. "Minimize the maintenance costs" was taken out of the pretest questionnaire at the suggestion of some in the AED who mentioned that few contracts are written with maintenance provisions. It was noted by previous review of the industry contracts that they did exclude maintenance. Two examples of maintenance terms follow.

1. On straight rentals on non-tractor equipment the lessee agrees to maintain said machinery and equipment in the same condition as when delivered to it by lessor, usual wear and

> tear excepted, and to pay all claims and damages arising from defects therein or from the use of handling of said machinery and equipment, . . . on all tractor equipment the conditions in paragraph 5 apply except that the lessee agrees to fully maintain the machinery covered in this contract while in his possession . . . with no exception made for usual wear and tear. On all rentals with purchase options the conditions in paragraph 5 will apply with the exception that the lessee agrees to fully maintain non-tractor equipment as well as tractor equipment with no exception made for usual wear and tear.[1]
>
> 2. Service: (a) Lessee will pay for and provide all electric power, oil, gasoline and lubricants consumed by and required for each Unit, and all repairs, parts and supplies necessary therefore.
>
> (b) Lessee will at its sole expense at all times during the term of this Agreement maintain each Unit in good operating order, repair, condition and appearance and keep the same protected from the elements.[2]

The latter of the two previous quotes from rental-leasing agreements, was adopted by John Deere for new equipment. That agreement carries a six months warranty on the reverse side of the last page, covering materials and workmanship, but this does not constitute a waiver of the lease conditions.

It seems clear that distributors do not intend rental-leasing to include maintenance ("gross lease"). Rather, maintenance seems to be a marketing aid that must be given to assure that the conditions are satisfactory and that the machinery is in good order. Contractors expect the service, for after

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[1] Terms and Conditions of typical AED Contract, p. 2.

[2] Equipment Lease Agreement, Boothe Leasing Corporation, used by the John Deere Co. for their customers.

all, "80% of those who lease don't read the contract or provide the required insurance.[1] Many distributors are also aware of this "obligation by default" for the thesis survey indicated that 45.2% include normal maintenance in their contracts and expect the practice to continue.

Because in some cases, more than one answer was checked in the contractor questionnaire, all of the indicated percentages in those categories that were used were added as points that were adjusted to 100%. The percentages were adjusted by differential weighting, for comparison with the distributors' analysis of why contractors rent. Sometimes more than one reason was checked by those who replied to the thesis survey and in those instances, a random number table was used to select the number to tabulate. Distributors were asked to make a distinction between the rental-leasing variations since it was thought that the reasons are different. A last line was left open for an inserted answer so that a forced choice did not have to be made. The distributors could then specify a reason rather than select the most important from the ones given. Framing the question in this way led to some additional information. "Meet bonding

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[1] Interview with Leslie Willson; U. S. Fidelity and Guaranty, Insurance; Lansing, Michigan; February 7, 1961.

TABLE 16

Reasons Why Contractors Rent and / or Lease as Viewed by the Contractor and Distributor

Some Principal Reasons for Rental, Rental-purchase and Straight Leasing	Reasons Checked by Contractors	Distributor Checks of Why Contractors Obtain		Checks as a percent for Rental and Rental-purchases		Percents		
	Rental and Rental-purchases	Rental and Rental Purchase	Rental-leasing	Contractors	Distributors	Difference in Evaluation	Distributor Checks for Rental-Leasing	Difference in Evaluation
	I	II	III	Ip	IIp	Ip$\pm$IIp	IIIp	Ip$\pm$IIIp
1 Need equipment for short period	67[a]	71	71	37	37	0[b]	27	10
2 Can pay for machine easier	40	41	53	22	21	1	20	2
3 Deduct payment for income tax	30	24	43	16	13	3	17	1
4 Try equipment before buying	25	16	17	14	7	7	7	7
5 Conserve working capital	12	30	54	7	16	9[c]	21	14[c]
6 Want newest machines	8	11	21	4	6	2	8	4
	182	193	259	100	100	22[c]	100	38

requirements" was inserted by two repliers and mentioned in personal letters by two others. The score might have been much higher for that reply if it had been listed. This is recognized in the complete analysis.

In Table 16 there is a comparison of the reasons given by contractors for renting with the distributors' perception of contractors' motives to rent and lease. The first two columns, rental and rental-purchase, when changed to percentages (Ip and IIp), are used for the first comparison. Because finance leasing was still in the embryo stage at the time of the contractor survey, most contractors apparently omitted this in their reasoning, thinking only in terms of rental arrangements. The predominance of (a) in the table, appears to support this judgment. They view it as short-term; non-committing. Distributors realized this fully and made no error in the comprehension of contractors' reasons, (b) The sum of percentage differences (22) was not found to be a significant difference.[1] In summary, distributors did very well in analyzing the relative importance of the reasons why contractors rent equipment.

The last two columns of this table indicate total distributor replies for renting and leasing and the inferential

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[1]Computed T was 1.25; T = 2.57 at the 5% level of confidence with 5 degrees of freedom.

discrepancies in evaluation of contractor motives. When the reasons for finance leasing were introduced, percentage differences appeared. The sum of percentage differences (38) indicates significant difference.[1] The fifth reason for renting and leasing showed a difference (c) in both comparisons. One basic factor contributed to this. The wording was changed in the thesis questionnaire to state the reason in terms presently used in this industry.

From the comparison data above, it seems that distributors have an accurate perception in interpreting rental motivations of contractors, but do not accurately perceive the reasons for leasing. One suggestion is recommended. From noting the differences at (c) and conducting a preliminary content analysis of some representative distributor ads, an overstress of the "conserve working capital" appeal was found. An adjustment could be made in this part of their effort.

Changes in the Market and Profit

In this section attention is directed to basic changes that may occur in the sales and the profits of the distributor as the result of marketing effort. Principal attention is directed to the relation of rental-leasing to the profitability of the firm.

[1] Computed T was 16.2; T = 2.57 at the 5% level of confidence with 5 degrees of freedom.

Before the distributors were asked to review the advantages and disadvantages of rental-leasing activity or record their personal feelings toward it, they were asked what the effects of the variations of it were on their sales and profits. This question is shown below with the answers (number of checks) that were received.

TABLE 17

Effect of Rental-Leasing on Sales and Profits

Will each of the below increase (or slow the decrease) of:		Total Sales? Yes	Total Sales? No		Profits? Yes	Profits? No
Rentals without the intent of purchasing	1)	51	43	2)	70	22
Rental-purchase with an option to buy that may be exercised .	3)	87	9	4)	75	13
Finance lease with no option to purchase and payments equal to full price	5)	49	35	6)	49	30

Inasmuch as no population figures are available for Table 17 and some of the other tables that follow, statistical analysis was applied to check if the numbers of "yes" and "no" were significantly different from a 50-50 chance division for the distributor population. From this analysis of Table 17, it was seen that most distributors feel that rentals will increase profits (2), and rental-purchase business will increase both sales (3) and profits (4). From the other answers, there is

an inclination to believe that the effects are beneficial for the distributors, but no clear indication is given.

Now that some of the market results have been briefly examined, one can inspect the application of marketing effort to accomplish the profit increases in the individual firms.

The following questions were placed two pages later in the questionnaire in hopes of preventing bias from an attempt to make these answers correspond to those previously recorded.

Rank <u>each</u> according to its profit percent of "sales." <u>Put (1) for the least</u> profit percentage, through 2,3,(4) for the greatest percentage:		Rank according to the amount of your marketing "sales" effort used to promote each. Rate (1) for least effort, through (4) for greatest marketing effort:	
26. Outright sales	4	30. Rentals	2
27. Finance leases	3	31. Finance leases	1
28. Rentals	1	32. Rental-purchase	3
29. Rental-purchase	2	33. Outright sales	4

$\rho = .4$

The above example shows how one respondent marked the answers. The lines connecting the two columns are drawn in by the writer for this example. It should be noted that the number 4 was used for the "greatest," since a percentage of profit on sales was asked first. Four percent is higher than 3 percent, 3 percent than 2 percent, and so forth. This ranking association could have helped distributors for these might be realistic actual percentages. As a check on the ranking

accuracy, the answers were checked with those of question 35 ("What percentage of your 1960 marketing effort was for rental and leasing?"). If their rental and leasing effort was less than 50% and they recorded a 4 for any of the rental-leasing variations, the total rank portion was disregarded. This only happened on two of the questionnaires.

In the above answer, the lines indicate that three discrepancies occurred. One was that the least effort was put on marketing the finance lease, while the person believed that this earned the second highest profit percentage. There were two differences (2d) in this rank. The other two disparities had only (1d) each. The rank correlation (ρ) is positive, .4. It is noted that this is not statistically significant alone, but it is significant when averaged with the other 94 rank correlations.

All firm replies were subjected to this rank correlation in similar fashion and the weighted results of their scores are presented in Table 18.

The average of the rank correlations (+.16) indicates some positive relationship between profits earned and marketing efforts; however, it is far from a perfect correlation (+1.0). It is obvious from the low average rank correlation, that the firms do very little correlating between marketing efforts and profits earned, as a percentage of sales. Other specific interrelating factors are noted later.

TABLE 18

Rank Correlations of Profits, as a Percentage of Sales and the Marketing Efforts

Rank Correlation	Number of Firms Reporting
+1.0	21
.8	11
.6	2
.4	12
.2	8
0	5
- .2	8
- .4	9
- .6	1
- .8	10
-1.0	8
	95

It should not be construed that the investigator suggested what variations of distribution ought to be the most profitable for the firm. It may be that, in reality, the rental-purchase is the least profitable for some firms (four specified that answer), while it is the most profitable for 20 others. It is only suggested that their greatest marketing effort should be on the methods of distribution that offer them the most profit, assuming marginal net profit is equal to the previous net profit per unit.

No definite patterns developed in the column ranks. In ranking profit from the highest to the lowest, the following order appeared nine times:

Finance leases	4
Rental-purchase	3
Rentals	2
Outright sales	1

There was such diversity that all of the 24 possible combinations of profitability ranking were utilized.

The marketing effort ranking had a little more standardization. The following order of effort was given 21 times. Only 14 of the 24 possible combinations were used.

Outright sales	4
Rental-purchase	3
Rentals	2
Finance leases	1

Twenty-one replies had correlations of +1.0, i.e., marketing effort was directed in accordance with profit. There is, of course, the possibility that some of these respondents arranged their ranking so that it would show no discrepancies. This possibility cannot be measured, but even with 21 perfect rankings only 5 had all the ranks in the same order, indicating that almost no uniformity exists among firms as to profit and effort ranking. A uniformity that may exist in the marketing effort is that 45 firms put their second highest effort upon the rental-purchase plans. A majority of dealers do not put their least effort on it or realize their lowest profits from it. Thirty-nine of them put greatest effort on outright sales, with their second greatest effort on rental-purchases.

It seemed desirable to check the significance of proper direction of marketing activity, so an analysis was made of those firms with positive correlations of efforts to profit in contrast to those with negative correlations. The profit standard used was the median for all distributors, 2.25% profit as a percentage of sales.

TABLE 19

Relation of Proper Marketing Direction and Net Profits, as a Percentage of Sales

Correlation of Efforts and Profits	----- Firms Reporting Profits -----	
	Above Median	Below Median
Positive	34	10
Negative	17	20

Firms directing marketing effort expenditures in relation to profits from the alternative distribution methods fared significantly better.[1] It has been found here that those applying marketing effort where the profit as a percent of sales is the highest, have a higher profit as a percentage of sales for their firm. This indicates that the respondents probably directed their effort as they indicated in the ranking, and that marketing effort bears a favorable relation to profit.

[1]Chi-square, $\chi^2 = 8.75$; 3.84 or above is necessary to show a significant difference with 1 degree of freedom.

The discussion of profit has been, to this point, centered on profit as a percentage of sales. It is realized that this is only one indicator of profit for the business, others being profit percentage on investment, working capital, and borrowed and invested capital. The percentage of sales was chosen because it is used frequently by the AED as a measuring guide. It is also realized that some distributors record their leases and rentals as sales immediately, while others choose to carry them on their books as rental income.

As some indication of the relation of profits as a percentage of sales to total profits as distributors would visualize them, one can compare the relative effectiveness of the variations on increasing total profits as answered in survey questions 2, 4, and 6 with the relative profitability of the variations, as indicated by the number who rated them as providing the greatest or next greatest profit as a percentage of sales. The reader can then see the comparison of profit as a percentage of sales and profit as the businessman evaluates it. This is shown in the following table.

TABLE 20

Relationship of Firm Profits and Profits as a Percent of Sales

	I	II	III	IV	V
Rental-Leasing Variations	Number Who Indicated It Increases Firm Profit	Firms Ranking It Greatest or Next Greatest in Profit as Percentage of Sales	Effectiveness of Increasing: Firm Profit I/194 Percent	Effectiveness of Increasing: Sales Profit II/133 Percent	Percent of Difference
Rentals	70	44	36	33	3
Rental-purchase	75	58	39	43	4[a]
Finance lease	49	31	25	24	1
	194	133	100	100	8

The rental-purchase variation is the most effective for increasing total profits (75) and earns the highest or next highest profit, as a percentage of sales (58). When these are expressed in percentages, there is only a difference (a) of 4%. Total differences from the three categories were 8%. We can see from this that the distributors rate the profit as a percentage of sales in close association with firm profits and may use them interchangeably.

It is unlikely that easier credit for the rental or rental-purchase makes for a great increase in sales or profits. The firms' attitudes toward credit restrictions are expressed in Table 21.

TABLE 21

Comparative Credit Restrictions on Rental-Leasing

If a customer's credit position was too poor for a financed sale, would you normally give him a:

	Yes	No
rental?	52	42
rental-purchase?	33	60
finance lease recommendation?	2	76

A significant number of distributors indicated that the customer with a credit position below the requirements for a finance sale should not be extended the opportunity for either the rental-purchase or finance lease plan.

Division of the Rental-Leasing Income

Income from rental and leasing activity now accounts for about 21.6% of the distributors' total sales. The distributor attitude towards this activity can be seen by a comparison to the percentage of income they would like to be receiving from this business--26%. They desire an increase of 4.4%. The number of distributors who would like rental-leasing to increase, stay the same, or decrease is seen in the following table.

TABLE 22

Distributor Desires for Rental-Leasing Compared with the Percentage They Are Now Doing

Number of Firms	Wish Percentage Would:
44	Increase
18	Stay Same
23	Decrease
85	

The two measures noted above, 1) the percentage change of all firms (21.6% to 26%), and 2) the number of firms desiring more rental-leasing, indicate that distributors would like rental-leasing to be a slightly greater portion of their total sales.

Table 23 indicates the division of the 21.6% rental-leasing activity that is carried on by the distributors. The 21.6% of total sales represents 100% of the rental and leasing effort. The percentages for the variations indicate the portions of the total 21.6%.

The graph following the table below is a least squares, trend line projection of the adjusted figures for construction equipment shipments since the end of World War II. Corrected for cyclical variation, the sales for 1960 are $1.6 billion. In 1965, sales will be about $2.8 billion. These two figures represent the bases on which leasing activity is computed and projected.

TABLE 23

Rental-Leasing Activity as a Part of
Equipment Distribution

Rental-Leasing as Part of Total Sales	At Present		Expected in 1965		Percent Change Expected
	Percent	Dollars	Percent	Dollars	
	21.6	366 mil.	35.7	1 bil.	14.1
Variations of Rental-Leasing:					
Rentals	35	128 mil.	34	340 mil.	-1
Rental-purchase	53	194	48	480	-5
Finance lease	12	44	18	180	+6
	100	$366	100	$1000 mil.	

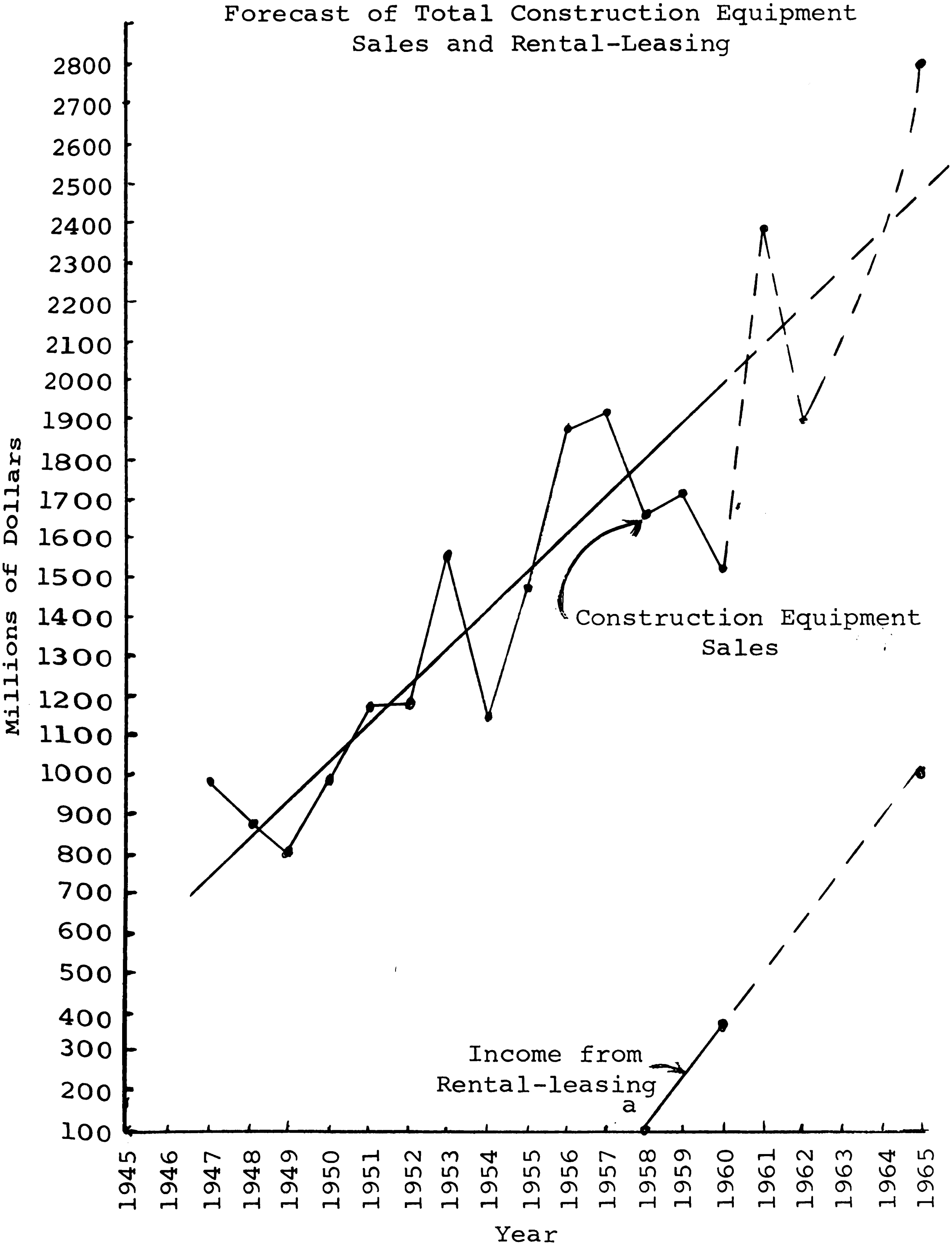
The dollar value of finance leasing is $44 million. This is the total value of the equipment and not the rental payments because independent lessors pay the full price to companies. The lease is recorded as a sale on the books of the distributor. The $44 million is about 2.75% of total equipment sales. The $44 million is also 6% less than the 1959 value of $47.1 million.[1] This decrease in finance leasing occurred in a year when total construction equipment sales dropped about 24.5%.[2] The rate of decline of finance leasing was only about one-fourth the rate of decline for total construction equipment sales.

[1] Personal interview with Robert Sheridan, President of Nationwide Leasing Co., Chicago, April 21, 1961. Figure based on an industry survey.

[2] Current Industrial Reports, Construction Machinery, 4th quarter, M35D(60)-4, March 6, 1961, Bureau of Census, U.S. Department of Commerce.

TABLE 24

Forecast of Total Construction Equipment Sales and Rental-Leasing



[a] Estimate by M. Spronck, "Lease the Machines You Need Now," loc. cit.

Extension of Leasing Activity

An inspection of the reasons why various distributors start to rent and lease may help in visualizing the effort that they give to it and the use they make of it. They were asked to check the main reason for starting rental-leasing. The results are given below.

TABLE 25

The Main Reasons To Start Rental and Leasing

Reasons	Firms	
Competitive reasons:		57
meet competitive practice	35	
meet contractor demands	22	
Income reasons:		33
provide income when sales were down	8	
increase total profit	25	
Offer new sales ideas		4
		94

There is strong indication that the initial entries into the rental-leasing business were to defend the scope of their markets. Only 29 of the replies--"increase total profit" and "offer new sales idea"--showed rental-leasing as an offensive marketing strategy.

The business conditions that aided the growth of rental-leasing are given in Table 26. It is significant that the

main considerations are monetary.[1]

TABLE 26

Conditions That Aid Rental-Leasing Growth

Conditions		Firms
Monetary restrictions upon contractors		57
tight money	44	
present depreciation rates	9	
bonding requirements	4	
Business uncertainty		14
Less ownership desire		12
Oversupply of equipment		13

It is important to note that restrictions placed on the capital-raising potential of the contractors may force them to turn to rental-leasing. The money, of course, must be provided by someone else. This is usually the distributor. Fifty-one distributors signified that they were the main providers of rental - leasing funds. Banks supply the most capital for 22 distributors. That is double the number of those who depend on either the manufacturers' credit corporation or the finance companies for rental-leasing monies. Only one contractor does most of his financing through an independent leasing company.

[1]Computed chi-square (χ^2) = 60.58. χ^2 = 7.815 at the 5% level with 3 degrees of freedom.

Finance leasing is quite distinctive from the other variations and should be examined in detail separately. When the distributors were asked how it was mainly utilized, they indicated the uses shown in Table 27.

TABLE 27

Main Use of Finance Leasing

Use	Firms	
Primary sales use		9
Opening idea	2	
Primary sales tool	6	
Others	1	
Secondary sales use		74
Last resort	27	
Alternative plan	10	
Special occasions	37	
		83

These numerous uses can contrastingly be placed in two categories, namely, primary and secondary uses in marketing. This breakdown serves to clarify some of the reasons why finance leasing has not grown to be an emphatically important variation of rental-leasing.

It is significant that most distributors use finance leasing only as a secondary selling method.[1] They attempt to

[1] Computed T = 11.7. T = 1.96 at the 5% level.

use it when the other tactics have been unsuccessful in producing a sale. The reasons for using the lease in this manner might be more evident after inspecting the problems expressed in the three following tables.

TABLE 28

Serious Problems of Finance Leasing Through an Independent Leasing Company

Problems	Firms	
Loss of importance as a distributor:		58
Lessors may start buying direct from the manufacturer	34	
Loss of control of used equipment market	4	
Contractors may start dealing directly with lessors	20	
Disruptive situations:		36
Misunderstandings may arise over income tax provisions	6	
Further barrier to best service relationships	14	
Difficult to arrange	2	
		94

Distributors are not easily aroused by possible interferences in their marketing channels for they know their importance to the manufacturer and contractor. For example, a New Hampshire dealer was even questioning the "authenticity of such a leasing company," for many leasing firms do not

have local offices. They are concerned, however, that they may not always make a reasonable profit on sales. They do not wish to become just a supply house for parts, receiving a small profit for inventorying the equipment. Some distributors find leasing arrangements too cumbersome. In an interview with a large distributor in Missouri, he related, "We find that it takes too much time and detail work in doing business with some these West Coast houses."[1]

Further substantiation of difficulties in the implementation of finance leasing in comparison with rental and rental-purchase can be seen in the following table.

TABLE 29

Serious Sales Problems with Rental-Leasing

Problems	Number of Firms Reporting		
	Rental	Rental-Purchase	Finance Lease
Growth problems:	39	47	50
Complicated contracts	4	11	23
Misunderstanding with contractors	28	19	12
Lack of knowledge about its purpose	7	17	15
Personal selling:	23	28	9
Salesmen prefer to sell the equipment	14	13	3
Sales commissions	7	13	5
No problems	2	2	1
	62	75	59

[1]Interview, Dec. 28, 1960. For obvious reasons, identity is withheld.

With rentals, it is sometimes difficult to obtain the rents from the contractor. With rental-purchase and leasing, it is troublesome to have outside financing approved. Additional difficulties with financing appear in the replies set forth in the following table.

TABLE 30

Disadvantages to the Distributor with Rental-Leasing

Disadvantages		Number of Firms Reporting		
		Rental	Rental-Purchase	Finance Lease
It may replace a sale	1	18	11	4
Builds up too much used equipment	2	23	10	5
Difficult to arrange financing	3	12	30	25
Difficult to collect payments and damages	4	30	16	6
Property and income tax uncertainties	5	9	15	14
Sales tax liability	6			1
		92	82	55

There are fewer replies that concern finance leases for only 38 of the 100 respondents indicated that they used this method of distribution. Although they were asked to check

what they felt to be true, many hesitated to comment without the actual experience.

Table 30, above, reveals no predominant disadvantages for any one variation. It does illustrate, however, the shift in frequency of problems from one method of leasing to another. The following fact, nevertheless, is revealed by the answers in the three previous tables. To speak of advantages or disadvantages of rental-leasing is meaningless unless the comments are related to the specific variation being discussed.

Composition of Rental-Leasing Services

Some distributors restrict the types of equipment that they will provide on a rental basis. Others advertise only some types, but will rent other units if they receive calls for them or there is "no way to avoid it."

TABLE 31

Number of Firms Engaged in Renting Each Type of Construction Equipment

Type of Equipment	Number of Firms
Heavy equipment (H) includes rollers and screening plants, etc.	62
Medium equipment (M) includes wheel tractors and scales, etc.	66
Light equipment (L) includes conveyors and forms, etc.	68

There was no significant association of types of equipment rented with profits, sales, or problems. It was noted that of the five firms with rental-leasing exceeding 60% of their total sales, four of these rented and leased out only light and medium equipment. Only one of these four had sales over the median of $1.92 million.

Table 32 shows the stipulations and benefits accompanying a rental-leasing contract from an average distributor.

TABLE 32

Stipulations and Benefits of Rental-Leasing from Distributors

	Percent Now	Percent Expected in 1965
Require advance rentals greater than first month's rent	9.6%	15.3%
Have contract provisions standardized	76.8%	71.4%
Have normal maintenance included in the rates	45.2%	42.8%

Distributors expect that more contracts will require substantial rentals in advance. A factor of this increased desire for rentals in advance is the lax payment by contractors as expressed by a previous table. Rental payments usually apply to the end months of the contract so that some financial protection is assured.

The words, "Associated Equipment Distributors" or letters, "AED" are not present on the rental contract provided through the Association. The practice in the industry concerning rental and rental-purchase is standardized, although portions of the contracts are changed in certain states to receive the legal benefits accorded to those who comply with statute provisions. For example, Maryland requires the rental fees and the guarantor to be listed on the face of the lease. Rental rates vary from area to area and two respondents mentioned that rates are the subject of "fierce competition."

The typical AED contract does not make provision for the distributors to pay for maintenance and this seems to be in antithesis with the "maintenance included" percentage. This situation becomes clear when one realizes that much of the maintenance given is as a matter of course from the beginning, and is continued to hold a close bond with the contractor-lessee. Most of the free maintenance is limited to smaller repairs and corrections.

Evaluation of the Hypotheses

The paper was designed so that the content would be focused on areas that assist in understanding the variations and actions in construction equipment rental-leasing with some emphasis on the extent of straight leasing. A review of the

literature, interviews, and a survey questionnaire were used to gather the data to test the hypotheses. Up to this point, the findings were set forth in discourse fashion, interwoven with quotes, tables, calculations, and logical inferences. Capsules of pertinent evidence, with a judgment at the end, will now be listed after each hypothesis concerning construction equipment marketing.

Hypothesis 1. <u>There is a close relation between the marketing effort for rental-leasing and its percentage of total sales</u>.

a) The difference between the average percentage of the total marketing effort used for rental-leasing (25%) and the average percentage of total "sales" resulting from rental-leasing (21.6%), could occur by chance.[1] In marketing terms, there is a similarity between the amount of rental-leasing and the effort used to foster it.

b) The following analysis is made of the greatest marketing efforts by firms for rental-leasing compared with efforts for outright sale, and the result on total distribution.

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[1] Computed Student's T was 1.09. T = 1.96 at the 5% level of confidence.

TABLE 33

Responsiveness of Distribution Methods to Marketing Effort

Method of Distribution	Number of Firms Using Greatest Effort (4)	---- Percent of --- Firms	Distribution	Difference in Percent
Outright sales	71	80	78.4	1.6
Rental-leasing	17	20	21.6	1.6
	88	100	100.0	3.2

TABLE 34

Effectiveness of Marketing Effort for Rental-Leasing Volume

Difference, to the nearest 5%, between percent of total promotion for rental-leasing and the rental-leasing percent of total sales	Number of firms experiencing the given difference
Percentage Difference	Number
0	25
5	29
10	17
0-10%	71
15	13
20	10
25	3
30	2
45	1
	100

c) As seen above, most firms have a 0-10% difference.

An approximate 10% of difference between the percentages of efforts and results could be normally expected. Thus, firms experiencing less than 10% of difference show reasonably close alignment of their promotional effort and "sales" from the alternatives to purchase. Seventy-one of the firms experiencing "sales" in proportion to effort illustrate significantly the effectiveness of marketing effort when directed at the alternatives to purchase.[1] There is close relation of rental-leasing promotion and the results from it.

d) The comparisons made in a), Table 33, and Table 34 indicate that the differences between the percentage of marketing effort for rental-leasing and the rental-leasing activity are usually small. The investigator also checked these percentages to determine their relationship at the various degrees of rental-leasing (proportion of firm sales). It was found that marketing effort for increasing rental-leasing was most effective when it represented between 23 and 33 percent of the total marketing effort.[2]

Efforts usually "lead"[3] rental-leasing activity. Thus,

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[1]Computed T = 4.2; T = 1.96 at the 5% level of confidence.

[2]Normal process for evaluating "Controllable Determinants". Compare J. Howard, Marketing Management (Homewood, Illinois: R. D. Irwin, 1957), pp. 70-74. Elasticity (e) of marketing effort is approximately 3.

[3]The lack of "instantaneous adjustment", assumed in demand analysis theory, complicates the measurement of causal effects. Compare J. Howard, loc. cit.

the increase in marketing effort might not be the result of firms witnessing an increase in rental-leasing and then exerting effort in proportion. Distributors feel that efforts can cause rental-leasing. They wish rental-leasing to be 26% of their sales and they devote 25% of their effort for it. Although there is strong indication that marketing effort is the independent variable and increases rental-leasing; rapid expansion of the market, cyclical sales patterns (as shown in Table 24), and seasonal variations prevent absolute conclusiveness. Individual firms, however, can determine the relationship by analysis of their budgeted efforts and results over a time period of rental-leasing experience.

e) There is a close relation between marketing effort for rental-leasing and its percentage of total sales.

Hypothesis 2. The greatest marketing efforts are directed at those methods of distribution that earn the highest profits.

a) A rank correlation between effort and profit as a percentage of sales was calculated for each firm, and results were averaged in Table 18. There is only a slight positive correlation, .16.

b) The comparison in Table 20 exemplified that profit as a percentage of sale was identified with profit for the firm.

c) When marketing effort was directed according to profits, firms earned profits above the distributor' median of 2.25% of sales (Table 19).

d) Only 5 of the 21 perfect correlations indicated any pattern of ranking. Extensive differences exist between firms.

e) Emotional feelings can affect activity:

> "We consider rentals as a curse."
> "When they want to rent, we talk them out of it."

f) As pictured in Table 25, only 27% (25) started rental-leasing to increase profits; most entered it as a defensive competition maneuver.

g) The greatest marketing efforts are not directed at those methods of distribution that earn the highest profits, as a percentage of sales.

Hypothesis 3. Straight leasing is not promoted as a primary marketing method.

a) Table 27 shows that finance (straight) leasing use has a secondary place in the sales and marketing effort. It is not used creatively to make more outright sales.

b) Only 36% of the distributors engage in straight leasing.

c) Fifty-eight of the distributors expressed concern about the distributors' loss of importance in the channel of distribution (Table 28). This is a seemingly sufficient reason to refrain from developing leasing fully.

d) Eighty-five percent of the firms, as illustrated in Table 29, sense a general lack of understanding of leasing and, therefore, cannot promote it to a great extent without a complementary "educational program."

e) Supplementary comments lend support to the hypothesis. One interviewee stated, "I wish they [manufacturers] would get out of the finance business." A respondent from South Dakota wrote, "Just started [it] here the last couple of months"; and from West Virginia, "we do not recommend the finance lease."

f) The above reasons, indicate that straight leasing is not promoted as a primary marketing method.

Hypothesis 4. <u>Straight leasing does not account for a large portion of equipment distribution</u>.

a) Straight leasing accounts for 12% of the total rental-leasing business, as figured in Table 22. This is only about 2.8% of all construction equipment sold.

b) Only one distributor uses an independent leasing company as the main source of lease financing.

c) The dollar volume is only $44 million and this is confirmed by another main source of information.

d) Straight leasing is not used where credit restrictions prevent a financed sale (Table 21).

e) For the reasons above, the hypothesis is accepted.

CHAPTER V

MARKETING ADJUSTMENTS FOR RENTAL-LEASING PROGRAMS

An analysis of customers' attitudes comprises an important input for marketing strategy in the case of construction equipment as with any other goods or services. Accordingly, it is worthwhile to examine the advantages and disadvantages of various forms of rental-leasing as perceived by the contractor as lessee.

Evaluation of the Reasons for Rental-leasing by the Contractor

There were significant differences shown in Table 16 between the importance accorded to reasons for rental-leasing as viewed by the contractors and the importance as perceived by distributors. These discrepancies in viewpoint may stem at least in part from faulty marketing feedback to the distributors. Another reason for the differences noted may be due to the assessment by the distributor of the validity of the reasons listed. The distributor respondents may have voiced "acceptable" reasons while believing other "unacceptable" reasons germane. This mode of response, if the conjecture holds, is analogous to the guest making an "excuse" to the hostess for not being prompt when the true reason cannot be mentioned to her. The marketer also may have difficulty in

stating the reasons for a customer's action when he believes that these reasons are irrational, incompatible, invalid, immoral, or illegal. Answers by the distributors may, in part, reflect how distributors think contractors ought to be influenced to rent or lease.

In Table 35 are set forth the benefits to the contractor-lessee of straight leasing, rental-purchase, and rental. The table is followed by a critical analysis and explanation of some of these benefits.

Bonding requirements are met more readily when rental-purchase or renting is used rather than leasing. Over 14 references to this were made in the replies to the questionnaire, all unsolicited. Even larger numbers might have mentioned this if a specific statement about bonding had been included. Earlier reference was made to bonding. It will be recalled that the bondsmen's appraisal is less favorable if a long-term finance lease obligation is mentioned in the balance sheet than if no such contract has been incurred. Notwithstanding this effect of a lease on eligibility for bonding, a study of 600 companies revealed that 189 firms did disclose the leases in the financial statements.[1]

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[1] American Institute of Accountants, Accounting Trends and Techniques in Published Corporate Annual Reports (New York: American Institute of Accountants, 1953) (7th ed.), p. 16.

TABLE 35

Advantages of Rental-Leasing to the Lessee-Contractor

	Variations		
	Straight Leasing	Rental Purchase	Rental
Easier to get bonding	Sometimes	Yes	Yes
Better Balance sheet appearance	Usually	Yes	Yes
Rent when credit prohibits buying	No	No	Yes
Promotes credit position	Yes	Sometimes	No
Easier to obtain than purchase	Sometimes	Yes	Yes
Long-term payments	Yes	Rarely	No
Full 100% financing	Yes	Yes	Yes
Conserve working capital	Yes	Yes	Yes
Flexible to needs	No	Yes	Yes
Use modern and latest equipment	Sometimes	Yes	Yes
Test new equipment	No	Yes	Yes
Can project future costs	No	No	Yes
Cut bookwork	Yes	Yes	Yes
Quick expansion of facilities	No	Yes	Yes
Verifies contract costs	Yes	No	Yes
Uninterrupted service	No	Yes	Yes
Reduce maintenance costs	No	Usually	Yes
Obtain replacement equipment quickly	No	Yes	Yes
Leverage to get service	No	Yes	Yes
Postpones taxes	Yes	No	Yes
Short-term use	No	Seldom	Yes
Retain control of business	Yes	Yes	Yes

In a separate survey of 512 financial corporations, 65% reported that companies who use the lease are allowed "greater credit than debt financing."[1] More equipment can be obtained through the lease than if funds were borrowed to purchase. There are fewer restrictions placed upon the lessee than upon a borrower. Many lenders do not think to restrict the further use of the long-term lease, although this commitment may prohibit making payments on the outstanding lease obligation. Banks look favorably upon a company that can get a long-term lease. They feel that if it qualified to obtain a lease under the close scrutiny that lessors give to financial standing, it has a proved condition, and so is capable of handling more credit.[2] The writer was permitted to see some correspondence (not addressed to him), in which an officer of one of the leading leasing companies refused to aid an association (not the AED) in organizing a program to finance equipment purchased from their distributor members. The leasing company did not wish to help because most of the buyers were small firms who perhaps could not obtain a lease anyway due to their financial positions. The lessor remarked that to eliminate any ill feelings that might develop from the lease

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[1] R. Vancil and R. Anthony, op. cit., p. 129.

[2] Personal interview with Mr. Frank Price, Trust Officer, LaSalle National Bank, Chicago, April 21, 1961.

refusal for the association, the distributor, and the lessor, it would be best not to join forces.[1]

The survey returns in the present study indicated that most distributors will not recommend a finance lease if a contractor's credit position is too unstable to be granted a conditional sale or chattel mortgage contract. Many distributors realize that finance leases are difficult to obtain. If the distributor recommends a contractor for a lease, and it is refused, this will cause the lessor company to doubt the distributor's ability to evaluate contractor credit capacity.[2] There is an indication that distributors may be influenced to grant a rental more readily than a rental-purchase when the credit rating is marginal. Incidentally, there is stability in this preference, for the pretest respondents ranked these tendencies in the same way.

"Can pay for machine easier," given as a reason for leasing, can have many different meanings. Some leases run for five years, and possibly the smaller payments each month would permit some contractors to utilize it. "Leases frequently are written for longer terms than those offered by bankers on loan repayment schedules."[3] Many banks, however,

[1] For obvious reasons, the source cannot be cited.

[2] Lester Powell, loc. cit.

[3] Frank Griesinger, "The Pros and Cons of Leasing," Harvard Business Review, Vol. 33, No. 2 (March-April, 1955), p. 83.

require the execution of notes and mortgages in addition to the lease papers. The details of the process may actually be more involved.[1]

The conservation of working capital has been an overstressed reason for leasing. Many times the profit ratio based on working capital is not a good measure of business success. The error of this kind of thinking can be illustrated. Suppose a contractor was making 17% net profit on $50,000 of working capital with a $200,000 fixed investment. He now sells $100,000 of his crushers, cleaners, drills, and tractors and rents or leases them. His accountant takes $100,000 from fixed assets and transfers the cash to current assets, increasing working capital to $150,000. His profit will not triple, will it? Instead, the percentage of profit on working capital is now 5.7% rather than 17%. The fact is--for this to be a valid reason for rental-leasing the contractor must have a profitable alternative use for the capital that is released.

Renting can be a vehicle for expansion. Monies can be released for alternative capital investments, for example, plant expansion. Additional borrowing is also a possible way to expand. Contractors should realize, however, that as they approach the end of their "line of credit," the interest rate

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[1] *Ibid.*, p. 89.

rises. This "next-loan" interest percentage is the one to compare with renting rates. If this loan rate is higher than the renting rate, it may be wiser to obtain rental equipment.

If additional equipment is needed for a specific "cost plus" contract, it may be much easier to verify the cost of needed units through rent receipts than through depreciation schedule evidence. Some construction equipment may not be required after the contract period and the cost of selling it (with any losses suffered) may not be incurred until after contract payment has been received. Depreciation is sometimes difficult to show or compute for a short period. Allowances for it may not equal the actual expense incurred. "Some corporate officers feel that rental expense is more acceptable to contract auditors than depreciation on fixed-asset purchase."[1] It is easier to allocate expenses, forecast costs, and compute bids when the costs are stable and the equipment is available.

Lessors advertise 100% financing. A term purchase requires a down payment, but leasing requires only rental payment. In some cases, this is 3.3% of the price each month. All costs of financing with the lease are borne by the distributor or lessor. The usual down payment under a purchase contract is 25% for most industries. However, it is closer to 10%

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[1]F. Griesinger, *op. cit.*, p. 86.

in the construction equipment industry.[1] The discussion about extent of financing, then, concerns an extra 6.7% (10-3.3). Lessors lease only to financially sound firms. In those cases where credit is no problem, "it is just as safe to sell equipment with little or no down payment as it is to enter upon a long-term lease with no initial deposit."[2]

When the conditions mentioned earlier under Tax Aspects are met, the rental payments may be deductible. Many lessors feel that it is the lessee's responsibility to care for his own tax problems.[3] Until further tax rulings are made, the status will not be completely clear. Even assuming full deduction, the tax over the long-run amounts to no less than the tax would be on an outright purchase taking into account interest and depreciation, using, for the latter, either the straight line or the sum-of-the-digits method of deduction. Leasing just accelerates deductions and postpones tax. When lease payments are completed and renewal rentals are being paid, interest and depreciation are still being deducted under the purchase plan. Unincorporated contractors may wish to

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[1] Business and Defense Services Administration, Construction Machinery Review and Outlook for 1960 (Washington, D. C.: U.S. Department of Commerce, July 18, 1960), p. 8.

[2] Karl H. MacDonald, "Is the Leasing Boom Really Healthy?," Construction Equipment News (May, 1960), p. 21.

[3] Taylor, op. cit., p. 27.

lease and rent much of their equipment during the high profit years in order that more of the actual expenses incurred would be deductible in those years resulting in leveled expenses, lower tax rates, and greater retained income in the long run.

Few lessors mean to include maintenance. The majority who use the AED contract (76.8%) expressly exclude it. Yet, many see themselves as forced to grant maintenance assistance because someone has to take special care of the equipment. Contractors often use "down equipment" as an excuse for non-payment of rentals. This excuse acts as leverage for better service. Replacement equipment is quickly provided. Work can be resumed. Few finance leases are written with a maintenance clause included and the third-party lessor is generally not bothered with the threat of non-payment due to "down equipment." He has no repair facilities!

The predominant reason for rental is for short-term or one job use. This rental use is usually confined to either: (1) light and medium equipment such as masonry saws, chain hoists, air compressors, and similar items, or (2) renting from other contractors if heavy equipment is needed for a particular job. Distributors hesitate, for example, to rent out a power shovel for less than a season or a six months' contract. Heavy equipment requires too much servicing for brief use. If a contractor rents a shovel to another

contractor, he usually wants to supply his operator. The lessee, on the other hand, wants to use his own operator since the reason for getting the unit may have been to keep his own operator busy. At $3.65 an hour, productivity from labor is a great incentive to have usable equipment. One Missouri distributor suggested that labor conditions play a large role in rental growth.[1]

Now the disadvantages are summarized in Table 36.

TABLE 36

Disadvantages of Rental-Leasing to the Lessee

	Variations		
	Straight Leasing	Rental-Purchase	Rental
Distributor supervision and inspection	Sometimes	Yes	Yes
Limited hours of use	No	Yes	Yes
Equipment below standards	No	Sometimes	Often
Misunderstandings with distributor	No	Sometimes	Sometimes
Finance costs higher	Yes	Sometimes	Sometimes
Without residual value	Yes	No	Yes
Lose protection from price increase	Yes	No	Yes
Promotes fly-by-night competitors	No	Sometimes	Yes
Forego pride of owner-ship	Yes	No	Yes
Some moral and social restraint	Yes	No	Yes
Equipment sometimes unavailable	No	No	Yes

[1]Letter from a respondent which accompanied a questionnaire. Name withheld for reasons mentioned earlier.

Disadvantages of Rental-Leasing to the Lessee-Contractor

The contractor pays a rate based on the stipulated hours of use. If he exceeds the eight hours a day, he pays one-eighth of the daily rate for each hour of overtime. Contractors such as Muelenbeck, one of the larger Michigan firms, run their equipment for 20 hours (2-10 hour shifts with a 4 hour maintenance period). Some distributors have Servimeters on the equipment that register the hours of use. The equipment cannot be sublet without written consent. Finance lessors also can inspect equipment. An example of this, written in a contract, is shown below.

> Lessor or its representatives may for the purpose of inspection, at all reasonable times, enter upon a job, building, or place where the equipment may be . . . and remove the equipment forthwith, without notice to lessee, if the equipment is in the opinion of the lessor, being used beyond its capacity or in any manner improperly cared for or abused.[1]

"Proper use" can be a source of disagreement and misunderstanding with distributors. Distributors consider this danger as the most serious sales problem with rentals (30 out of 64 of the respondents so indicated). Hours of use are not limited in the finance lease.

Rental equipment is sometimes below standards. The engines may be ready for an overhaul, the cables may be stretched,

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[1]"Standard 5 Year Lease Form," Clark Leasing Corp., Buchanan, Michigan.

or the metal structure may be fatigued. A large contractor stated that the performance of rental equipment was 10 to 20% below standard.[1] Rental-purchase equipment is in much better repair, for the dealer wants to make the best impression so that a sale will result. Equipment on finance lease is normally new with the manufacturer's warranty in force.

Leasing companies borrow their money from banks and finance companies. Although many of them feel that they are primarily a marketing concern, financing is a major service they market. If they are to make a profit on borrowed funds, they must charge a higher interest rate. With no equity at the end of the lease or protection from price increases, the contractor must scrutinize his alternative profit potentials to justify diverting the money from the purchase of equipment.

Many contractors are proud of their business. They dislike seeing "short-timers" come in the business, grab off a profitable contract, and then leave because of poor workmanship. Marginally managed firms can enter the business. Many people forget, however, that renting also gives flexibility so that marginal firms may leave the business. With little investment, liquidation is easier, and the inferior contractor can enter into other employment. In contrast to this theory,

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[1] F. Babione, "Marketing Equipment . . .," *op. cit.*, p. 124.

the reader will note that often the marginally unprofitable businesses stay, while those making moderate profits leave. The corner store may "break-even" for years, while the store making only 5% on investment terminates business. This occurs because: (1) some companies see clearly the alternative opportunities to invest, and (2) they have the mobility to make the transition to another business.

Advantages and Disadvantages of Rental-leasing to the Distributor-Lessor

Evidence reflecting on the marketing potential of rental-leasing is now inspected in greater detail than in the previous critique of the lessee situation. The same format will be followed. Table 37 summarizes the advantages. The following statements are analyses of some of the advantages.

The merchandise-lease plans may help the salesman. Not only are marketing aids furnished for selling the customer the new idea, but also the lessor pays for the equipment immediately so that the full commission check can be paid.[1] The leases are usually "without recourse" to the distributor, and if non-payment occurs, the leasing company bears the responsibility and the risk of loss. Most of the distributors

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[1] T. Kenny, "Leasing as a Sales-Tool," Dun's Review and Modern Industry, Vol. 75 (February, 1960), p. 102.

TABLE 37

Advantages of Rental-leasing to Lessor-Distributors

	Variations		
	Straight Leasing	Rental-Purchase	Rental
Offer new "sales" idea	Yes	Sometimes	Sometimes
Expand market	Sometimes	Yes	Sometimes
Get re-sale equipment	Possible	Yes	Yes
Place equipment on trial basis	No	Yes	Yes
Meet competition	Yes	Yes	Yes
Tax sale of rental equipment as "capital gains"	No	No	Sometimes
Rent collectible from bondsman	Sometimes	Rarely	Sometimes
Receive full price soon	Yes	No	No
Less price negotiation	Yes	No	No
Immediate commissions to the salesmen	Yes	No	No
Contract with lower management	Yes	Yes	Yes
Less credit restrictions	Rarely	Infrequently	Sometimes
Increase profits	Sometimes	Yes	Yes
Level income over years	No	Yes	Yes
Sales assistance from financier	Yes	No	No
Have plan without using company funds	Yes	Sometimes	No
Buffer income in recessions	No	Yes	Yes
Develop supplementary lines	Sometimes	Yes	Yes
Easier to sell supplies	Sometimes	Yes	Yes
Service revenue	Usually	Yes	Sometimes
Research and develop new ideas	No	No	Yes
Lead to additional sales	Sometimes	Yes	Yes
Investment of idle funds	Yes	Yes	Yes

included in the study realized this advantage and only half of those who indicated rental-leasing problems for the salesmen, felt that they were applicable also to the finance lease.

The sales and profit results from the straight lease offered no clear pattern in the distributor survey. This perhaps was due to the limited experience that most of the distributors had with it. For an idea of the contribution of straight leasing to sales and profit, one can look at other industries. The following examples are indicative:

> Jones and Lamson leased $87,000 [of machine tools] and had plans for another $200,000 in the first 7 weeks of their plan. They forecasted a 25% sales increase from the lease plan.
>
> Addressograph-Multigraph found most of the new lessees became repetitive buyers of their supplies.
>
> Do All of Des Plaines, Illinois, started leasing when sales were slow. They now are selling many cutting tools for those same machines.
>
> Kearney and Trecker found that they and <u>most others in the machine tool industry experience a 20% increase in their total business</u> as a result of leasing.[1]

The illustrations above are from a few of the companies that have found that leasing increases their sales and profits. However, not all companies are satisfied with the market performance of leasing. W. Peck of the Raymond Corporation related, "the company's year-old leasing plan deserves no

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[1] T. Jones, <u>op. cit</u>., p. 23.

credit for the 25% increase in volume for it has had poor acceptance."[1]

After examining the financial statements and sales records of Clark, Yale and Towne, and the Deere and Company; studying the effects of leasing in various companies as reported in the literature; and discussing the sales aspect with distributors and lessors; the writer concluded that it could increase sales for the construction equipment industry, although 5% would be about the limit of the effect. Profits would increase, for under the present arrangements with leasing companies, the price (with profit) is paid to the dealer after the transaction.

Many times under a leasing contract, it is easier to <u>get the full price</u> for the equipment. The buyer is more concerned with the cost each month than he is with total cost. The distributor also is using payment terms which are subject to the approval of the leasing company. If the payments are not quite as low as what the contractor is seeking, the distributor can place the burden on the leasing company. For example, he can say, "I tried to get that arrangement, but they did come through with this offer which is pretty close to it." This third-party approach may help to gain an acceptance.

Leasing offers the dealer an excellent excuse to return

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[1] <u>Ibid</u>.

to the job site and see if the contractor is ready to buy. In the long-term finance leases, the end of the period is another time to renegotiate for a sale.

There may be instances where the state government, municipality, or some federally regulated concern may find it against regulations to buy new equipment, but they may sign for chattel leases. As an example of such a restriction, public carriers must have ICC approval to buy, but they can lease without obtaining permission.[1]

Some distributors might find that being able to sell to lessors without having to buy the trade-in later may offer a solution to an overabundance of used equipment. The lessor would dispose of the equipment, although if it is a heavy rig, as is much construction equipment, it is likely to be sold in the area in which he bought it. This may mean competition for the distributor in the used equipment market.

The advantage of stability of sales and income over recession periods is limited to the rental and rental-purchase arrangements. For rental business, the distributor needs more money to begin. In general business declines, income will continue from the rentals. Their "debt paying ability will improve . . . their income will continue . . . this will make their

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[1] C. W. Steadman, *op. cit.*, p. 523.

earning position more stable."[1] Companies, such as Boothe Leasing, who now confine 90% of the leases to firms with AAA-1 ratings, will perhaps hesitate to invest money in enterprises out of geographic reach under conditions that are uncertain. A serious business recession has not yet brought them to the test. Company lessors, such as Clark Equipment, who are now more liberal in their credit than independent lessors, may finance marginal leases during business slowdowns.

Funds for equipment financing are difficult to obtain. Department of Commerce surveys show that credit refusals are more prevalent when the requests are for one year or longer. Small firms, wishing to sell their securities find it very difficult to raise equity capital. A study by the Securities and Exchange Commission found only 23% of the securities offered, sold within one year.[2] Closely held corporations may hesitate to float public issues because, if they do, they may have to open the doors for review by persons not familiar with contractor problems. Lessors provide funds without impairing distributor or contractor ownership control.

Normally a distributor would like to sell to those who can make initial payments. The distributor's decision to provide

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[1]Eiteman and Davisson, op. cit., p. 70.

[2]A. Kaplan, Small Business: Its Place and Problems (New York: McGraw-Hill Book Co., 1948), p. 152.

equipment on rental becomes difficult when a contractor, though he can make the rental payment, has a borderline credit rating. The contractor may not be able to continue paying rent. A large down payment requirement may prevent the contractor from buying under the term purchase plan, but with a rental plan, the distributor must say "no." This may cause ill feelings that could hurt future business. It is difficult sometimes for the distributor to rationalize his action, especially if the contractor later does well. Municipalities may have the necessary credit rating, but even on a three year rental (lease) plan for them, Wayne Manufacturing requires payments on a sweeper to be "two monthly payments to be paid on delivery,--two at $287.49, and one monthly payment each 30 days thereafter until paid in full."[1] Even governmental units are subjected to cash flow and liquidity tests. This is further indication that finance lessors are cautious in this new approach of rental-leasing.

Lease expiration provides <u>used equipment for re-rent</u>. A distributor can have more control of the total market by either renting this equipment or selling it to customers. These, in turn, might later buy new equipment when a

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[1] Wayne Rental Agreement, Computation and Pay Out Schedule, Wayne Manufacturing Co., Pomona, California.

a particular unit has worked out well on the job. One dealer sold a used fork-lift for a trial operation, and later the customer bought a new one after the equipment proved a success under operating conditions.[1] Hyster Company has a new "custom leasing plan" that can provide full servicing at only a few dollars a month more than the "net" leasing plan. There is feeling among some management personnel that because lessees do not usually treat the equipment with normal care, service may be a problem. It is conceivable that the customers would demand better service than they would normally expect if they bought it. One dealer suggested, "We don't want more service--we are here to sell equipment and not to do a lot of minor repair work."

The distributor has an opportunity for the sale of used equipment with returns from rentals and rental-purchases. He may make a contract with an independent lessor for the return of equipment originally sold to the lessor by him.[2] The problem is often the sale, rather than purchase of used equipment. The used equipment inventory builds up. "The distributor has reached this point by over-generous appraisals of old iron

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[1]Interview, Mr. Gilbert Yates, Jr., of the Hyster Company--Grand Rapids office, Grand Rapids, Michigan, February 26, 1961.

[2]H. Greenfield and F. Griesinger, op. cit., p. 100.

that has outlived its economic life."[1] When the rented equipment is sold, added tax benefits may be received. If the distributor receives most of his income from rentals, "current rulings seem to indicate that profits on disposal of equipment may be treated as capital gain."[2] The 27% tax difference is saved if sales and capital gain represent a minor portion of his income.

The short-term rental affords the distributor the opportunity to put the trade-in to some use while the repair department schedules the overhaul or reconditioning of it. If a number of trade-ins are on the same type of equipment, the distributor can build up a rental fleet and use this to augment his income. A large Missouri distributor commented in a letter, "We would have been out of business, if it hadn't been for our rental business." Rentals were used here for a two-months' period when sales were slow. When good weather came business improved, and rentals took second place in importance with outright sales first.

By strict interpretation, capital investment is not made when a lease is signed by a contractor or his purchasing agent. "Expense for continued use of property to which the taxpayer

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[1] R. S. Tucker, "Realistic Acquisition of Used Equipment," Construction Equipment News (November, 1960), p. 13.

[2] F. Griesinger, "Pros and Cons of Leasing," op. cit., p. 87.

has no title is not capital investment."[1] Therefore, if the contractor's corporate by-laws state that the purchasing agent can purchase items other than for capital investment, he is permitted to sign a lease. This is true even if the full cost of the lease must equal the purchase price.

Profit in the market during cyclical business conditions is one result of having continuous rental income. Rather than high sales with high profits and high income tax (for those individuals who receive most of the company's profits), the income is leveled over a 3 to 10 year period. Should the income tax rate later fall, the tax would be a lower percent, and the total tax paid would be less. At the time of a recession when tax rates have the best chance of being cut, the rental income is not only evened out for the best income position of the company, but the taxes on that income are lower. This is a double advantage to the lessor. It must be recognized that many customers during the recession would like to "get out from under" the lease. Consequently, the customer's credit position must undergo extensive scrutiny prior to the lease. During recession periods, when many contractors attempt to keep capital outlay at a minimum, the lease may be the only method they would consider to improve their operations or

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[1] Ostheimer, 1 BTA 18 (December 13, 1960).

replace obsolete equipment.

Additional income from service work may be an added dividend from rental operations. This is most true with the full-maintenance, or "gross" rentals. However, even when the lessee pays the service costs, his inclination is to return to the lessor or owner. Service generates additional income, although one can be discouraged while attempting to please all contractor-lessees.

All variations of rental-leasing can lead to sales. A contractor may have no intention of buying, but after continued use, he may realize he needs the equipment permanently. An Oregon distributor is sympathetic to the plight of the contractor who is "forced by obsolete tax laws to set up equipment purchases on a long time depreciation schedule and cannot be encouraged to make purchases under those conditions." He said further, "We rent air compressors (as well as other items) and from these rentals we have developed several sales that might otherwise not have been possible."[1] "One well-known manufacturer of machine tools recently announced that it has negotiated leases exceeding $3 million while outright sales of machine tools resulting from lease advertising exceeded

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[1]Personal letter with returned questionnaire, May 22, 1961.

$3.5 million."[1]

Many distributors do not enjoy the problem of having idle funds to invest. Should they, leases offer a means to use more money than term sales, for no down payment is received and more contractors use the extra credit. They offer a use of funds controllable by the business with a "typical 9% simple interest return on capital invested in leases."[2] This may not be equal to what they could receive on an additional inventory or marketing effort investment. The 1959 before-tax earnings were 11.95% on total invested capital for all distributors.[3]

The summarized disadvantages are shown in the table on the following page.

Normal wear and tear is difficult to quantify, and much confusion and difference of opinion can arise when an attempt is made to put a dollar value on wear. Using rubber tires as an example, many distributors now will gauge each tire prior to the equipment rental and then regauge each upon the return of the equipment. After discounting normal wear, which

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[1] George Hartman, "Should your Plant Lease Production Equipment," Technical Aids for Small Manufacturers, No. 21, Small Business Administration (October, 1957), p. 2.

[2] F. Griesinger, "Pros and Cons of Leasing," op. cit., p. 88.

[3] AED, Cost of Doing Business, op. cit., p. 42.

TABLE 38

Disadvantages of Being a Lessor

	Variations		
	Straight Leasing	Rental-Purchase	Rental
Bear risk of obsolescence	No	Yes	Yes
Higher depreciation and obsolescence rate	Sometimes	Sometimes	Yes
More bookkeeping	No	Yes	Yes
Limited market for customers	Yes	No	No
Must be almost maintenance-free for best relations	No	Yes	Yes
May have limited market for resale	No	Yes	Yes
Free maintenance service	No	Sometimes	Sometimes
Lose used equipment market	Sometimes	No	No
Build used inventory too high	No	Sometimes	Yes
Requires additional funds	No	Sometimes	Yes
Tax and insurance uncertainty	Yes	Yes	Yes
Third-party between distributor and customer	Yes	No	No
May deal with marginal buyers	No	Sometimes	Yes
Tie up working capital	No	Yes	Yes
Misunderstandings with contractors	No	Sometimes	Yes
Replace a sale	No	No	Sometimes
Danger of losing importance as a distributor	Doubtful	No	No
Limited to special equipment	No	Yes	Yes

has been standardized or agreed upon previously, distributors charge for any excess wear. Other elements of the equipment, such as bearings, scraper edges, and engines are still more difficult to evaluate. One operator of equipment in Michigan, a six year veteran, stated that, "Many times the rented equipment would be used on the rough shale and rocks while the owner's equipment would be used for the easier jobs or held back until better ground was uncovered." When asked how he knew when the equipment was rented, he remarked, "Just by the looks of it and noticing how they took care of it. If it was run-down and uncared for, it was rented." It has been estimated by some who have examined machinery under both ownership conditions, that the depreciation rate suffered on the rental equipment can be 20% higher than when it belongs to the contractor.[1] The construction foreman can influence the attitude of the operator toward his "rig" by giving incentives for proper operating. One construction equipment leasing company found "that their equipment is generally no more abused than any other type of [sic] term plan."[2]

Under the present AED contract, most of the details of the contract for the equipment, such as maintenance, taxes, and

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[1] F. Griesinger, "Pros and Cons of Leasing," op. cit., p. 77.

[2] "When to Lease or Not to Lease," a portion of the proceedings from the Canadian Association of Equipment Distributors (April 25, 1961).

insurance, must be arranged by the user. This may discourage the use of renting. If a distributor wants to increase his renting business, he may find it advantageous to handle more of these details.

Depreciating rented equipment may require extra bookwork. "The Internal Revenue Service is insistent that some party to the transaction should be depreciating the equipment."[1] If the contractor is claiming full rentals as expense while the dealer holds title, the latter is the likely one to figure depreciation.

Another of the important disadvantages to distributor renting is the inventory problem. Used equipment inventory in stock makes for a higher personal property tax. "In addition to his financing headaches, the dealer must worry whether the purchaser will 'purchase.' Too many 'purchasers,' turning down too many options empty the dealer's bank account and fill his yard with used iron."[2] He is also concerned about whether the lessee has taken out the insurance required. If damage is done by the equipment the owner is liable even though he was not the operator.[3] To meet this liability, many dealers

[1] F. Griesinger, "Pros and Cons of Leasing," op. cit., p. 87.

[2] "Rental Purchases," op. cit., p. 14.

[3] Charles J. Roger, Contractor, Detroit, related in an interview that he was held liable for personal damages on a leg severed by his crane, which was rented "fully operated" to another contractor and was under the direction of the lessee.

also insure as a costly additional precaution.

Seventy-two percent of the distributor respondents are concerned about their importance in the channel of distribution as leasing continues to grow. They see finance institutions making bids for leasing business and lessors taking larger portions of company's total business. Some witness automobiles now being purchased by leasing firms at $100 over dealers' cost. What does it mean to them? Little, for first, the situation is slightly different. Automobiles and office equipment are sold through company branches or sole distributorships. AED members sell for two or more companies on a franchise basis. Secondly, manufacturers tried selling their own equipment back in the 1920's and desired a change to the present system.[1] Thirdly, many distributors have contracts that prohibit direct purchases. Fourth, some leasing companies, one being KSM previously cited, say they will not buy or lease direct. U. S. Leasing Company makes mass purchases, but asks for no discounts.[2]

Present Conditions Influencing Rental-Leasing Potential

Rental-leasing in the construction equipment industry is

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[1] "The U. S. Industrial Outlook for '60," op. cit., p. 176.

[2] F. Cameron, "Now You Can Lease Almost Anything," American Business (December, 1959), p. 21.

influenced by financial considerations. Of non-marketing factors the distributor respondents indicated that rental-leasing is primarily the product of monetary considerations. These factors compose about 25% of the incentive for most lessees.[1] To properly evaluate the position that the distributor should take in his strategy for maximum benefit from the trends, we should inspect the present status of some considerations.

The disposal of government and military surplus following the Korean conflict reached its peak in 1957,[2] the same year in which many active auctions were held for construction equipment. Since then, liquidation of inventories by the General Services Administration has been under $200 million a year. When little of this low-priced used-equipment is available, contractors and other government purchasers may turn to more rental-leasing activity.

In a forecast for the leasing of construction equipment in 1960, these were postulated as the main reasons for a continued rise in activity:

1. More equipment manufacturers are using leasing as a sales tool to move their products;

2. More companies will lease their equipment to avoid

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[1] R. Vancil and R. Anthony, <u>op. cit</u>., p. 129.

[2] Construction Machinery and Equipment: Shipments and Related Data, 1958, <u>op. cit</u>., p. 4.

the pinch of tight money; and

3. More companies will be affected by the increasing technological progress which is speeding up obsolescence of machinery.[1]

On a later occasion, in a personal interview with the same person, who was the source for the previous comments, the forecast for the leasing activity was more pessimistic.[2] "That [construction equipment industry] is primarily for a short-term rental operation with maintenance included. The future is not as bright for us in that industry as it is in many others." To show a great contrast in thought, another person working for this person in the same office said, "That field [construction equipment industry] is ripe . . . we just need to apply more sales effort with them."[3]

With little change noted in the availability of money, other than the normal relaxation from an economic upswing, leasing of construction equipment should continue its gradient increase. Assuming business conditions remain approximately as they now are, marketing action will be the largest force influencing rental-leasing.

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[1] Robert Sheridan, "Equipment Leasing Rose During 1959," Michigan Roads and Construction (January 14, 1960), p. 7.

[2] Interview with Robert Sheridan, President of Nationwide Leasing Company, Chicago, April 21, 1961.

[3] Interviewee must remain anonymous for obvious reasons.

Changes in Marketing Strategy

Most distributors, consciously or unconsciously, adopt a business philosophy that guides their actions in the various phases of their business. A "mature" distributor, one who has been in business for some time and has reached the peak of sales growth, is unlikely to make all of the necessary changes for the most profitable distribution by rental-leasing. If he does not choose to pursue business in this field, a different strategy would make little difference. Enthusiasm would be lacking. If such were the case, his philosophy would have to be altered before strategy could be effective.

With the distributor's, "Cost and Variance Statement,"[1] he can determine the unusual costs in the rental business which are incurred. If corrections can be made that will make renting profitable, the marketing strategy should be organized. Most distributors have the account ledgers accessible, such as "Free service-material, Equipment rentals, and House Machinery and Equipment," which would furnish some of the data necessary for profit analysis.[2] Treating the rental

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[1]An accounting form that permits a distributor to forecast cost and profit from operations, and then compute how costs varied.

[2]The terms are indigenous to the distributor's business, but are similar to the inputs for most marketing management break-even analysis computations. Information from: Stevenson, Jordan, and Harrison, Inc., Planning for Greater Profits, manual for AED members (1953), pp. 35-45.

business as a "cost and profit center" can often give the distributor the initial direction for his efforts. As shown by the present survey, too many profit rankings exist to say categorically that any or all of the variations of rental-leasing are profitable for all firms.

Some marketing theorists state that strategy can be employed when some uncertainty is present, confidential information can be retained for determining the courses of action, and marketers can integrate the marketing mixes and provide bases for decision-making at the sales level.[1] Distributors find that their strategy is formulated upon similar characteristics. An explanation is now made of some strategy inputs.

Surveys, such as the one included in this study, should help distributors to understand the motivations of the customers for utilizing the variations of rental-leasing. They may also review their own thinking. To the question at the end of the thesis study, "What is the future of rental and leasing in your industry?," one distributor wrote, "Alarming, now that I review it!"

Many factors determine the selling requirements for the distributors. Three are particularly acute. They are:

1. The type of market: size, concentration, and other

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[1]John Howard, Marketing Management: Analysis and Decision (Homewood, Illinois: R. D. Irwin, 1957), p. 36.

characteristics.

2. The distributor's product line.

3. The particular customers that the distributor serves and their buying habits.[1]

Many distributors acknowledge the importance of these and accord attention to them.

Important factors determine profitable leasing operations. While none are absolutely mandatory, the following should be enunciated:

1. Service must be ample to hold customers while limited and controlled, or profitablility remains indeterminable.[2]

2. Renting or leasing should be recommended, without apology by the salesman or distributor, in those instances when desirable. It should not be used as a "way out" for placing the machine or it will degrade marketing effort.

3. New equipment should be emphasized. In 1935, 73% of the construction industry's equipment was over 10 years old. The trend is toward equipment use for shorter periods. Equipment of new design makes labor-saving methods possible.[3]

4. Distributors who have a Fixed Asset/Net Worth ratio of 30% or more usually have the financial stability to handle a portion of their own finance

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[1] Booz, Allen, and Hamilton, Sales Planning Manual, prepared for AED members (1955), p. 29.

[2] McNeill, op. cit., p. 425.

[3] "Orders for Equipment Increase in July," Engineering News-Record (October 13, 1960), p. 128.

leases.[1] This test was devised after careful study of industries for a publication, Leasing and the American Industry, now out of print. While distributors do not usually average a ratio that high, it is within the "50% range of common experience."

5. A contractor is not a good prospect unless all rentals and leases represent less than 35% of his net worth. This will give the distributor indication of the stability of the lessee and his intent to remain in the business.

6. The equipment should be income producing, if possible. This insures that income will be generated from that use of funds. Maintenance type equipment is sometimes released when profits are scarce and outlays have to be cut.

7. Inasmuch as a principal advantage to leasing lies in the freeing of capital, the contractor should be able to make 15% profit on working capital, before taxes, in order to consider it beneficial for him.[2] That profit would offset the usual added costs of leasing.

8. If the distributor decided to be a lessor, marketing effort should be placed on those items of equipment that have value to the customer at the end of the normal lease period of less than the potential profit made on the saved working capital.[3]

A Leasing Program and Possible Pitfalls

It is not the intent of the writer to present a format for profitable operations for the individual distributor, but some

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[1] William Heins, "Leasing Appealing to Paint Men," Oil, Paint, and Drug Report, Vol. 173 (February 3, 1958), p. 4.

[2] R. Sheridan, "How Leasing Equipment Compares in Cost with Purchasing," Baking Industry (February 20, 1960), p. 4.

[3] "The Pros and Cons of Leasing," Study by the Foundation for Management Research, Chicago (March, 1959).

helpful information has been pointed up. Many considerations have been mentioned about the lessor operations. Now a choice can be made by the distributor as to whether he will be the lessor himself or use a leasing company. This judgment can be best made after some of the pitfalls of rental-leasing are examined. Some of these pitfalls are:

1. Misunderstandings concerning maintenance, contracts, and the purposes of the various plans. Almost half of the distributors provide normal maintenance, yet do not include this in the contract. They may be granting service to keep a customer pleased. The distributor should, however, limit service virtually to the letter of the contract to protect his profit under competitive rates. He should also have a "gross rental and lease" plan available. This includes maintenance, with some limitations, in the contract. This also provides for a more favorable review by the Internal Revenue Service. The distributor is showing his ownership.[1]

2. Forcing the lease on those who are not psychologically adapted to it. Although profit is derived from the use, not the ownership of assets, there are many who consider rental-leasing as a violation of social mores.[2]

3. Overstating the tax benefits. The law is not clear and has been clouded for four years. While majority opinion is that the use of the purchase option disqualifies the contract as being an expense, a careful study expressed "purchase option rentals offer the advantages of immediate rental deductions for tax purposes . . . [except] when the lease agreement stipulates that the rentals may be applied in part,

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[1]F. Griesinger, "Lease or Own-Boon or Boondoggle?," Steel Service Center Institute, Miami Beach, Florida (May 15, 1960), p. 4.

[2]"Leasing Pitfalls to Avoid," Steel (April 5, 1957), p. 67.

as installments on the purchase price."[1]

4. Incorrect appraisal of obsolescence. Without experience, forecasting can be extremely difficult. One must calculate his rates with the extra 20% accelerated depreciation and obsolescence suffered when the non-owner uses the equipment. Supersedure of equipment must also be considered. Manufacturers of construction equipment have alluded to experience of a rise in sales when new equipment is marketed. They have also noted that sales may fall in the subsequent years, when improvements give the contractor more durable equipment.[2]

5. Beginning with insufficient funds. If customers must be turned away, leasing is a failure for them. If the distributor wants to be relieved of most of this concern and have help with the marketing aspects, a professional lessor is desirable. Even they have trouble, so one must select with caution. The Ryder System had to drastically curtail the size of the leases and withdrew offers in some areas of the equipment market recently because it had not correctly appraised the costs.

Pricing may serve more as a damper than an adjuster in marketing strategy. If the distributor's philosophy prevents him from encouraging rentals, he may raise the rental rates to a prohibitive proportion of investment value.

The Associated Equipment Distributors' Rental Rates for Construction Equipment, is now in its twelfth edition. In suburban areas, these rates are used consistently. In

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[1] Generally Accepted Accounting Principles for Contractors, American Institute of Certified Public Accountants, New York, p. 21.

[2] "Orders for Equipment Increase in July," Engineering News-Record (October 13, 1960), p. 128.

metropolises, competition determines adjustment while investment and overhead costs determine the minimum rate. Rates may be slightly less in rental-purchase contracts, for: (1) the time period is longer and more definite, and (2) profit will come with conversion to a sale. Straight lease rates are computed "by financial annuity tables without regard for the going rental rates on comparable properties."[1] The Contractor's Equipment-Ownership Expense shows the monthly cost of depreciation, interest, and other such expenses. For example, a cement plant costs 7.5% of the price for each working month. The AED rate is 10.2% The spread in rates serves as a pricing limitation. The rates, allowing for lessor profits and expenses, may converge in vigorously competitive areas.

Construction cost and construction equipment price indexes have been within 15 points of each other as they have risen together since 1949.[2] Construction equipment sales and total construction indicators have been within 10 points of each other. Construction equipment prices seldom parallel rental rates. In 1960, the list prices of equipment held

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[1] Gant, op. cit., p. 123.

[2] The Bureau of Labor Statistics publishes the equipment price index and Engineering News-Record, the construction cost index.

steady, while most of the rental charges fell about 2%.[1]

There are reasons why list prices were stable:

1. A McGraw-Hill construction equipment sales forecast caused misjudgment. Optimism was unfulfilled. The publisher realizes, however, that individual bargaining prices are much different from those in the indexes.

2. The new line introduced in June of that year kept the sales prices from making their usual ascent.

Reasons why rental rates fell are: (1) contractors had a record investment in new or "young" equipment so they did not have to rent much "modern" equipment; (2) equipment had relatively stable prices in 1955, 1956, and 1957, so contractors built an inventory; and (3) rates reflected the slowdown in construction from a cutback in the highway program and the 1959 steel strike.[2]

It has been seen that rental rates and prices can move in opposite directions; rate changing is only another element of the distributor's strategy adjustment.

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[1] "List Prices Steady and Up, But Most Rentals Dip," <u>Engineering News-Record</u> (December 22, 1960), p. 64.

[2] <u>Ibid</u>.

CHAPTER VI

SUMMARY AND CONCLUSIONS OF THE RESEARCH

The principal findings of the study are summarized briefly. These will be approximately in the reverse order of the research sequence. Results are listed; the survey and literature findings are shown; and the procedures used in the analysis are mentioned. Quantitative support for the results are set forth in earlier chapters and are not repeated. Subsidiary questions that were raised in Chapter Two are answered along with the main question, as set forth in the thesis title itself.

Results

The purpose of this study was to investigate the current practices and attitudes of construction equipment distributors with regard to marketing by alternatives to purchase. Marketing effort was compared with the profitability and volume of "sales" from the three major variations of rental-leasing, namely: Rentals, short-term and primarily used equipment; Rental-purchases, longer time periods with an option to purchase with the contract; Straight (true or finance) leases, specifying payments to equal the price and interest costs over a usual period of three years.

A survey of construction equipment distributors uncovered practices and attitudes to test four hypotheses. An informal presentation of the hypotheses and results follows:

1. The total amount of rental-leasing done by the distributors is proportionate to the amount of marketing effort used to encourage it. Rental-leasing makesup 21.6% of "sales," while 25% of the marketing effort is devoted to it.

2. Distributors exhibited only a slight tendency to place their greatest marketing efforts where the profits, as a percent of sales, were highest. The profit percentages do have qualifications, but two phenomena were seen: (a) profit percentages of sales were proportionate to total profits, and (b) firms placing efforts where profits were higher, earned above median profits, as a percentage of sales.

3. Straight (true or finance) leasing is not utilized as a primary marketing method. It is only used as a last resort or an alternative plan.

4. Straight leasing accounts for about 2.8% of the equipment sold, a small portion.

Other results of the survey and literature review gave helpful guides for marketing action:

1. Distributors feel rentals will increase total profits even though they may replace sales. Rental-purchase plans

increase both sales and profits. No definite distributor opinion was expressed on the effects of straight leasing on profits or sales, although Clark Equipment Company and Yale and Towne Manufacturing Company increased sales through leasing.

2. Competitive problems of rates and demands for service are serious; however, the distributors would like to do more rental-leasing. They forecast a significant increase of it by 1965. Growth of rental leasing should parallel the growth of construction equipment sales (same percentage increase).

3. The reasons why contractors rent were correctly appraised by distributors. A comparison showed that they do not correctly assess reasons why contractors lease.

4. State laws vary considerably on repossession rights. Bankruptcy laws allow rental payments to continue for one year with the equipment returning to the lessor.

5. Bonding regulations of many states require greater working capital positions to permit contractors to bid on the higher cost construction jobs.

Statistical tests were applied to the responses from mailed questionnaires sent to a random sample of Associated Equipment Distributors. Of the 201 questionnaires sent, 52.5% were returned. The respondents were adjudged typical in comparison with the profits as a percentage of sales and total

sales for all distributors. Extensive literature review, and interviews with lessors and distributors supplemented the data gathering.

The figure shown on the following page will illustrate the interrelationships in the construction equipment rental-leasing effort.

Conclusions

Answers to Practical Questions

The last section of Chapter Two listed five "Practical Questions for Examination." Brief answers to these questions, not mentioned elsewhere in the summary, follow:

1. Are the distinctions made in rental-leasing only of theoretical consequence? No. If a close examination of the practical differences between rentals, rental-purchases, and finance leases were made by all of the distributors, opinions about one variation would not influence the practices and consequent profitability of other variations. Firms might then promote at least one variation, instead of rejecting all of the alternatives to purchase.

These distinctions are of theoretical importance also. No clear distinctions are made in most of the marketing texts. However, the rental differs from the finance lease as much as

FIGURE 2

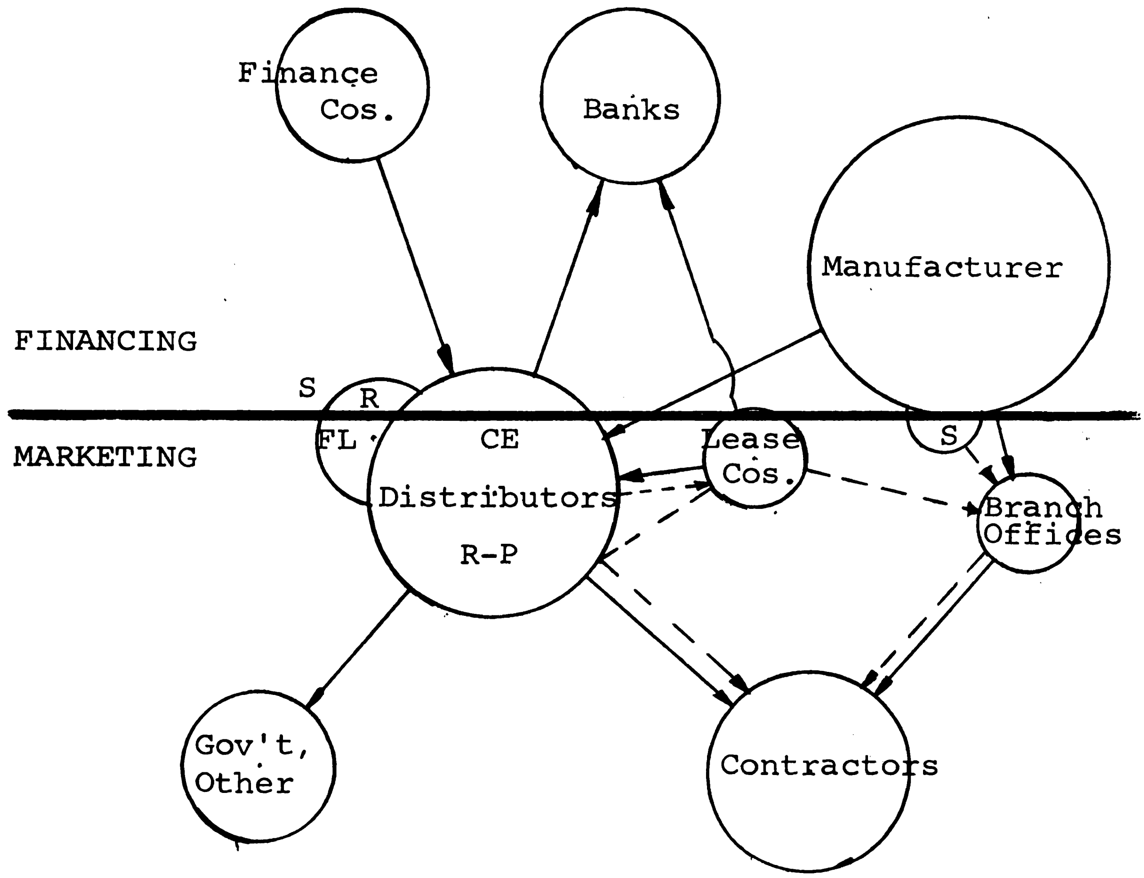
Institutions Involved in Marketing by Rental-leasing in the Construction Equipment Industry

Key: Circle size indicates approximate relative importance.

Lines indicate pattern of promotion.

Dotted lines indicate secondary effort.

S - Subsidiary FL - Finance Lease
R - Rental R-P - Rental-Purchase



Distributors market most of the construction equipment output. Renting and finance leasing plans can be transacted through the normal ledgers of the distributor; however, many of them find it beneficial to incorporate a subsidiary for tax advantages and to limit liability. The area below the double lines reflects marketing emphasis.

a time payment plan differs from the cash sale. These distinctions contribute to clear marketing thought and planning.

2. Does straight leasing increase the total market for industrial equipment? Yes. Clark Equipment experienced a rise in total sales attributable to the finance lease. Many other companies such as York, Yale and Towne, Kearney and Trecker have had similar results. The whole machine tool industry experienced an increased market. While construction equipment distributors thought that the rental-purchase plan increased their market, they were not as sure about the finance lease. Based on the results and business conditions now favoring its use, it appears that leasing will increase total sales.

3. Do the rental plans lead to an over-extension of free maintenance and service? Yes. Contracts are written without service provisions, yet about 45% of the distributors give some free maintenance. Being expensive to the distributor, "free" maintenance detracts from the profits. The contractor is seldom offered the choice to receive a "gross rental" contract (with maintenance); however, he expects some maintenance with the "net lease."

4. Does rental-leasing require a different marketing mix? Yes. Even motivations for each variation are different. The market is also different. Many customers will not qualify for

at least one of the plans. The leasing appeal should be of secondary importance in the general advertisements and used as an attention-getting method only after a specific prospect is qualified. If all three plans are available by a distributor, he could use a universal appeal as a central promotional theme. Care must be exercised so that any credit disqualification will not limit future business. Less personal selling is necessary to start a plan; however, customer satisfaction must be complete for the plan to continue (except finance leases). Contracts without maintenance clauses should be reviewed together-lessee and lessor--to prevent misunderstandings.

5. Has leasing in the construction equipment grown as fast as straight leasing in all industries? No. While the volume of construction equipment on lease ($42 million) in 1958 qualified the industry as being one of the top ten in the use of leasing, the industry dropped to about twenty-fifth place in 1960. The volume of construction equipment leasing has remained about the same for the last four years. Distributors now expect the volume of leasing to increase faster than distribution through other methods. There is indication that the construction equipment leasing growth pattern follows the all-industry average by about eight years (compare figures found in last page of Appendix).

General Conclusions

The lease will become more important to the marketing student and practitioner. One reason stems from its potential growth. It is being applied to more industries. Greater percentages of industrial sales are likely to result from leasing. Many of the provisions of rental-leasing are changing as a result of non-marketing influences. It will take an alert marketer to put the features into benefits for other industries. He should improvise ways to make the provisions clearer than they have been until now. A leasing study in an industry that serves both the industrial and consumer markets would be helpful to compare the different effects that seemingly exist.

Executives have been committed through their own business concepts to (1) acquire assets, and (2) increase sales. The latter concept has been recently reappraised in view of prevalent profit squeezes. The former must now be revalued with assistance from the social scientist so that attitudes can be defined and recast. If it is the use, rather than the ownership of capital goods that generates profit for customers, then marketers should be cognizant of this for maximum effectiveness of rental-leasing in their distribution program.

How effective are alternatives to purchase in the marketing

of construction equipment through distributors? They are about as effective as outright sales, since it was seen that profit percentages are similar and the volume of rental-leasing is relative to marketing effort. Further, replies and results revealed that, with the exception of the straight lease in certain instances, the alternatives to purchase can increase profits for the distributors. However, when the distributors did not place marketing effort emphasis on those variations of rental-leasing that were the most profitable for them, the alternatives were less effective, and the profits of those firms were below the median profits of 2.25% of sales. Questionnaire notations and interviewee comments often disclosed that it was the attitude of the marketer or the philosophy of the distributor that interfered with the effectiveness of the alternatives.

The appropriate question might now be--instead of "how effective are the alternatives to purchase in distributor marketing?"--"how can the distributor be encouraged to use effectively these alternatives to purchase?"

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APPENDIX

Will each of the following increase (or slow the decrease) of:

		Total Sales? YES	Total Sales? NO		Profits? YES	Profits? NO
Rentals without the intent of purchasing	1)	17	12	2)	17	10
Rental-purchase with an option to buy that can be exercised	3)	28	0	4)	26	2
Finance lease with no option to purchase and payments equal the full price	5)	17	8	6)	21	4

If a customer's credit position was too poor for a financed sale, would you normally give him a:

		YES	NO
rental?	7)	15	11
rental-purchase?	8)	11	15
finance lease recommendation?	9)	3	20

10) We make our highest return (per cent of profit) on:

6	1)	rentals
8	2)	rental-purchase
2	3)	finance leases
14	4)	financed sales

11) Are you a: 16 tractor, or 12 non-tractor distributor?

The principal reason why contractors want to use:
(Make one check in each column)

		(12) Rental	(13) Rental-Purchase	(14) Finance Lease
need equipment for a short period	1)	21		
can pay for machine easier	2)	1	21	5
deduct payments for income tax	3)	1	2	10
try equipment before buying	4)	3	3	
minimize maintenance costs	5)	2	2	1
want newest machines	6)			3
Conserve cash (working capital)	7)			2

(Other--briefly explain)

The principal disadvantage to the distributor in using:		(15) Rental	(16) Rental-Purchase	(17) Finance Lease
may replace a sale	1)	12	2	2
too much used equipment	2)	6	7	1
difficult to arrange financing	3)	3	7	4
difficult to collect payment, damages	4)	3	4	2
property and income tax uncertainties	5)	2	5	7
Insufficient income (Other--briefly explain)	6)	1	___	1

The most serious sales problem with:		(18) Rental	(19) Rental-Purchase	(20) Finance Lease
complicated contracts	1)	1	10	6
misunderstandings with the users	2)	10	4	1
people should know more about it	3)	2	2	5
salesmen prefer to sell	4)	3	6	3
sales commissions	5)	3	2	2
Equipment kept only a short time	6)	2	1	
Requires too much inventory (Briefly)	7)	1	2	

21) The condition that most aids the growth of rental and leasing is:

5	1)	present depreciation rates
13	2)	tight money
4	3)	business uncertainty
1	4)	less desire for ownership
5	5)	oversupply of equipment
1	6)	Our emphasis on it
1	7)	Need for a short time (Briefly)

Most of our rentals and leases are financed by:

12	1)	distributor (us)
4	2)	manufacturer credit corp.
7	3)	banks
4	4)	finance cos.
___	5)	independent leasing cos.

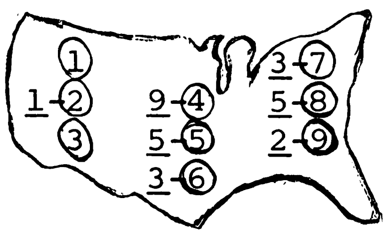
22) The main reason we started rental and leasing:

6 1) meet competitive practice
14 2) meet contractors' demands
2 3) provide income when sales were down
2 4) offer new sales idea
2 5) increase total profit
1 6) Introduce products
1 7) Our original business
1 8) Move used equipment

23) The most serious problem of finance leasing through an independent leasing company will probably be:

7 1) lessors may start buying direct from the maker
5 2) we may lose control of the used equipment market
3 3) misunderstandings may arise over income tax provisions
7 4) contractors may start dealing directly with lessors
1 5) further barrier to best-service relationships
1 6) Being used as a gimmick
2 7) Undesirable substitute for a sale
(Other, briefly explain)

24) Please circle the number that best shows the area of your business



25) Our sales in 1960 were $ [Average] $3.7 million [20 reporting]

26) Most of our rented and leased equipment is for an average period of 7 months.

27) The length of most of our rental-purchase agreements average 16 months.

Under 1 year	14 =	46%
1-2 years	14 =	46%
2-3 years	2 =	6%

* * * * * *

Please fill in the per cent (%) as closely as you can estimate it.

28) 71% of the purchase options are exercised?

29) 8% of your 1960 advertising effort was for rental and leasing?

30) Total rental and leasing dollars account for approximately what per cent of the company's total sales?

Now	I would like it to be now	I expect it to be in 1965
28%	26%	45%

33) Our total rental and leasing business is broken down as follows:

NOW		I expect it to be in 1965
25%	Rentals without the intent of purchase	27%
59%	Rental-purchase with an option to buy	55%
4%	Finance leases: no purchase option, payments equal price	12%

36) What per cent of your rental and leasing calls for:

32%	advance rentals greater than first month's rent	39%
44%	insurance (except liability) to be provided by you	61%
66%	contract provisions similar to the AED contract	87%

45) Finance leasing is MOST useful as a:

3 1) last resort
1 2) opening idea
6 3) primary sales tool
5 4) alternative plan
11 5) plan for special situations
1 6) big package deal
(Other--explain briefly)

APPENDIX

MICHIGAN STATE UNIVERSITY LEASING STUDY

You are well aware that there are three variations of rental and leasing. Rentals are usually short-term where there is no intent to buy. Rental-purchase contracts may later be converted to sales. The finance leases require payments to equal the price plus interest with no purchase options.

When these variations are noted, we hope you will make similar distinctions in your answers. Even if you don't use all the variations, your opinions will still be most helpful.

We think you will find completing this questionnaire a stimulating experience.

William J. E. Crissy
Alvin J. Bytwork

Please check (x,✓) the one best answer for each of the questions given.

****

Indicate after each type of rental and leasing, its effect on sales and profits.

Will each of the below increase (or slow the decrease) of:

		Total sales? Yes	Total sales? No		Profits? Yes	Profits? No
Rentals without the intent of purchasing	1.	51	43	2.	70	22
Rental-purchase with an option to buy that may be exercised	3.	87	9	4.	75	13
Finance lease with no option to purchase and payments equal the full price	5.	49	35	6.	49	30

If a customer's credit position was too poor for a financed sale, would you normally give him a:

		Yes	No
rental?	7.	52	42
rental-purchase?	8.	33	60
finance lease recommendation?	9.	2	76

10. We are a 48 tractor (or) 48 non-tractor distributor?

11. Most of our rented and leased equipment is for an average period of _____ months.

(1 yr. - 76 3 yrs. - 11
2 yrs.- 8 4 yrs. - 1)

Place one check under each variation of rental and leasing opposite the statement from the left that is most applicable.

The one main reason why contractors want to use:

		12 Rental		13 Rental-purchase		14 Finance lease
need equipment for a short period	1	70	1	1	1	
can pay for machine easier	2	1	2	40	2	12
deduct payments for income tax	3	13	3	11	3	19
try equipment before buying	4	4	4	12	4	1
conserve working capital	5	6	5	24	5	22
want newest machines	6	3	6	8	6	10
______________ (other-briefly explain)	7	2	7	1	7	3

Our single most serious sales problem with:

		15 Rental		16 Rental-purchase		17 Finance lease
complicated contracts	1	4	1	11	1	23
misunderstandings with contractors	2	28	2	19	2	12
lack of knowledge about its purpose	3	7	3	17	3	15
salesmen prefer to sell the equipment	4	14	4	13	4	3
sales commissions	5	7	5	13	5	5
______________ (other-briefly explain)	6	4	6	2	6	1

_______% of the purchase options are exercised.

____% of our 1960 marketing sales effort was for rental and leasi

The principal disadvantage to us with the:

	18 Rental		19 Rental-purchase		20 Finance lease	
it may replace a sale	1	18	1	11	1	4
builds up too much used equipment	2	23	2	10	2	5
difficult to arrange financing	3	12	3	30	3	25
difficult to collect payments and damages	4	30	4	16	4	6
property and income tax uncertainties	5	9	5	15	5	14
______ (briefly)	6	___	6	___	6	___

****

21 The most serious problem of finance leasing through an independent leasing company will probably be:

34 1 lessors may start buying direct from the manufacturer
4 2 we may lose some control of the used equipment market
6 3 misunderstandings may arise over income tax provisions
20 4 contractors may start dealing directly with lessors
14 5 further barrier to best service relationships
___ 6 ______________________________
(other-briefly explain)

22 Finance leasing is mostly used as a:

27 1 last resort
2 2 opening idea.
6 3 primary sales tool.
10 4 alternative plan.
37 5 plan for special situations
1 6 ______________________
(other-briefly explain)

23 Most of our rentals and leases are financed by:

51 1 distributor (us).
12 2 manufacturer credit corporations.
22 3 banks.
11 4 finance companies.
1 5 independent leasing companies.
___ 6 ______________________
(briefly)

Rank each according to its profit percent of "sales." Put (1) for the least profit percent, through 2,3,(4) for the greatest percent:

	1	2	3	4
26. Outright sales	34	17	19	25
27. Finance leases	24	27	19	12
28. Rentals	26	22	18	26
29. Rental-purchase	5	32	38	20

Rank according to the amount of your marketing "sales" effort used to promote each. Rank (1) for least effort, thru (4) for greatest marketing effort:

	1	2	3	4
30. Rentals	43	27	19	4
31. Finance leases	39	23	13	9
32. Rental-purchase	5	41	45	4
33. Outright sales	6	4	14	71

The questionnaire is unidentified, but the following is needed to check our sample with the averages in AED's Cost of Doing Business Survey.

Our sales for 1959 were $2,860,000 . Your figure may possibly be found in the Cost of Doing Business, page 23, top line.

Our percent of net profit as a % of sales before Federal Income Tax was ___________%. This figure may be on the same page, third line from the bottom.

****

Fill in the percent (%) as closely as you can estimate it.

Total dollars resulting from rental and leasing account for approximately what % of your company's total sales?

36. Now	37. I would like it to be now	38. I expect it to be in 1965
21.6%	26%	35.7%

Our total rental and leasing business is broken down as follows:

Now		I expect it to be in 1965
36.3%	Rentals without the intent of purchase	34.3%
53.4%	Rental-purchase with an option to buy	48.2%
12.6%	Finance leases: no purchase option, payments equal price	18.7%

The percent (%) of our rental and leasing that calls for:

9.6%	advance rentals greater than first month's rent	15.3%
76.8%	contract provisions similar to the AED contract	71.4%
45.2%	normal maintenance included in the rates	42.8%

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Appendix

True Industrial (Total) and Construction Equipment Leasing in the U.S.