White paper

Why financing should be the key component of an IT investment decision

Companies are often attracted by lease finance, but the range of benefits is still not always fully understood. This paper investigates the attraction of leasing technology assets from a number of different perspectives.

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Introduction

Financing new technology has a long history. If you go back to the middle of the nineteenth century and the birth of mass production, the new technologies of the day – things like harvesting machines from McCormack, and sewing machines from Singer – were all offered via installment credit or some other form of financing.

Today, from the home to the office, from the farm to the factory, financing is nearly always a viable option for acquiring access to new technology. Of course, nowadays, there are many different ways of financing - it all depends on how you need the financing to be structured.

So why is lease financing so attractive?

Benefits

Let's start with four of the more well-known financial reasons why leasing is considered an important option.

Cash

For most organizations, revenues and profits nearly always grab the headlines. But without access to cash, you can't run a business. Acquiring the use of new technology assets via a lease spreads the cost over the economic life of the product. Buying hardware outright creates an immediate dent in cash flow. Leasing is good for cash flow.

Cost

When most lease contracts are first signed, they are almost always based on a fixed rate of interest. So, signing a contract when the interest rate is at a low point can be beneficial as the overall cost of a lease will also be comparatively low as well as remaining stable throughout the duration of the agreement – typically some three to five years. Leasing at times of low interest rates help keep costs down for the duration of the lease.

Budgets

Most lease agreements are repaid with a fixed monthly or quarterly payment over an agreed term. This means that costs are predictable over the full period of the lease agreement, hence simplifying budgetary forecasts. Planning a revenue budget is a very time consuming process and is often based on multiple assumptions about future conditions and activities. These fixed monthly or quarterly rental payments take the guesswork out of budget setting, and contribute towards stable OpEx forecasts.

Tax

Not many of us have to consider the impact of corporate taxation on our decisions. But for the CFO, tax is a very real cost which needs to be managed just like any other cost to the business. In many jurisdictions, tax regulations can make lease finance a more cost effective option than acquiring an asset for cash. Relatively simple lease versus buy calculations - based on tax-adjusted discounted cash flows - often show that leasing generates a much better return over the economic life of the technology compared to a cash purchase alternative.

These four straightforward reasons why lease finance is attractive could be applied to almost any organization in almost any sector. Of course, their attraction might vary somewhat across geographic boundaries, thanks to the application of different accounting standards and different tax regimes. But generally, these are widely-accepted benefits of leasing over an outright purchase.

Different Perspectives

When we get inside an organization, different players in different functions can have completely different views on the benefits of lease finance. And this is certainly the case when it comes to information and communications technologies. There can be quite varied perspectives of lease finance when seen through the eyes of the CFO, or the CIO, or the users themselves.

As custodians of the organization's financial resources, the CFOs typically concentrate on the impact of leasing on budgets and performance metrics, and ultimately the income statement and the balance sheet. CIOs and users, on the other hand, are generally more interested in how best to manage technology assets through their lifecycle, while keeping a keen eye on managing their budgets.

For the last few years, research company IDC has undertaken an annual survey of technology buyers, seeking to understand how leasing is viewed by a number of organizations. While the ranking changes a little from year to year, the attraction of leasing can be divided into to two distinct categories - financial needs and operational needs. While IDC doesn't always make the distinction explicit, it seems fair to assume that this is down to the mix of CFOs and CIOs responding to the survey.

Financial Needs

At the top of IDC's list of drivers for financing technology resources are: conserving capital, contractual flexibility and aligning costs with benefits.

- **Capital** – Keeping the organization's balance sheet in good health is currently a major priority for most CFOs. As a result, capital budgets are feeling the pinch, and CapEx spend is severely curtailed in many industry sectors. This means that any form of lease finance which can take assets off the balance sheet is generally seen in a positive light. In most countries, where available, operating leases can do just that. Structuring a lease to conform to the relevant accounting standards is key. Your vendor's leasing specialist should be able to help there.

- **Flexibility** – Perhaps the most noticeable change in the last few years has been the inexorable movement of technology assets from the balance sheet of users to the balance sheet of providers. Many organizations are now less likely to be owners of assets and more likely to be operators of assets owned by others. This means a shift from using a CapEx budget to acquire technology assets to an OpEx budget to rent or hire assets, or increasingly to a 'subscribe to' service.
- **Alignment** – Most technology purchases need to demonstrate a positive business case before they can be approved by the capital committee or some similar screening and review body. Usually, the majority of the costs occur upfront, while the benefits occur through the whole life of the asset. This misalignment between costs and benefits may not matter over the long term. But in the short term, the impact can be problematic, especially at times of fiscal restraint. Leasing helps spread the costs over time, so the alignment of costs and benefits is much more visible.

Operational Needs

At the top of IDC's list are: protection against obsolescence, the safe disposal of retired products, and the need for speed when acquiring new technology.

- **Obsolescence** – As hardware advances continue to offer improved functionality and productivity, there is a need to protect any investment against the inevitable obsolescence of yesterday's technology. This is both a practical and operational necessity as well as a clear economic imperative. Depending on how they are initially structured, some leases do allow for a periodic technology refresh, or, at the end of an initial term, an easy segue to the next generation product.
- **Disposal** – There are two key drivers at play which govern how organizations consider the disposal of hardware. First, there's conformance to environmental regulations. Second, there's data security - making sure that all stored data is safely cleansed before disposal or recycling. Assuming that you choose a reputable vendor, leased hardware products should all be decommissioned and responsibly recycled or disposed of. This can also include certificated data wipe or data destruction, if required
- **Process** – While the first two operational needs consider end of life products, this third need is all about the start. As mentioned earlier, acquiring technology assets via a CapEx budget nearly always requires a business case. The process of preparing, presenting and seeking approval for CapEx spend can be long, complex and time-consuming. In contrast, setting up a conventional lease, where payments will come out of a cost centre or a profit centre, is nearly always much easier and quicker.

So there are quite different needs being addressed in a variety of ways by the flexibility of the leasing model. In addition, some organizations may want a slow start and gradual build-up in the cost of their lease - what's known as a step lease.

At times, it may also be important for the overall length of the contract to vary, although typically they are set-up to last between three and five years. And sometimes, leases are required to include all manner of installation costs, a combination of existing and upgraded hardware, and maybe software licenses and certain services.

But what of the different and quite specific requirements needed when deploying modern technologies? Specialist financing companies have had to get to grips with designing leasing products which can satisfy quite an unusual set of needs.

Specific Products

Standard finance products - such as a typical three or five year lease - will meet many of the needs of buyers of information technology products and services. But some needs can only be met via specific leasing structures which have been designed with very specific needs in mind.

Subscribe

There are the several variations of managed 'subscription services'. This is where you pay for what you use. As such, costs are generally more predictable; they're usually connected to some type of structured variable sage or seats; and they're nearly always expensed rather than capitalized.

For example, the requirement for additional server or storage capacity can be driven by all sorts of business needs, and at times demand can be irregular, resulting in difficult-to-predict peaks and troughs. Where leasing is a need, some vendors can offer financial solutions which are structured to accommodate a base level requirement, and then flexed with incremental buffer capacity which is only charged for when needed.

Migrate

Migrating from one technology platform to another, or consolidating some or all of your storage or server capacity, can also be managed via a structured lease agreement. Combining various products and services thanks say, to an acquisition or a planned relocation can also be managed in this way.

These highly bespoke agreements provide for the valuation, handling and buy-out of any surplus equipment. Then they allow for any credits, together with all incremental costs related to hardware, software, services, installation, training, maintenance and such like, to be included in a new lease agreement.

Outsource

Since Kodak instigated the first major IT outsourcing project back in 1989, there has been a huge variety of different outsourcing structures. These range from full outsourcing with a single supplier, through to best-of-breed consortia and various arrangements of primary contractors and sub-contractors.

But today, the fastest growing style of outsourcing is the discrete managed service contract, whether that be in-house, hosted or in the cloud. Most managed service contracts combine hardware, software and services in one contract. Financing often plays a role too, especially where hardware is part of the overall offer.

Requirements

Financing structures can be found to suit most requirements, and as we've seen, the combination of technology and financing can produce really quite sophisticated solutions.

But great care is needed to make the right decision. For example, most large publicly quoted corporations have to work to International Accounting Standards. Most other firms still work to their national GAAP – Generally Accepted Accounting Principles. And Government bodies have always had their own, quite local ways of controlling expenditure. In other words, who you are and where you are will almost certainly affect the ways in which financing can support your organization. So from the very start, it's important to work with a financing partner who really understands the rules you have to adhere to.

Selecting a suitable financing partner is clearly an important decision, so when is the best time to start investigating what financing has to offer? According to one of IDC's IT Leasing and Financing Surveys, almost one in three organizations looks into financing when they are first planning their project. IDC says that these are the organizations that have a "thorough understanding of the benefits of leasing and use all the services offered to them". IDC also says that these respondents "have a much higher awareness of how leasing can facilitate a good business value, and they have already made up their minds to lease before they make any decisions about which products to use". In terms of timing, the message is clear - start to engage with your chosen vendor as soon as you can if you want to fully understand what leasing can do for you.

Then, when working with your chosen partner, they should first help you clarify your needs and only then recommend the best financial solution to meet those needs. To help them do this well, you will need to explain fully all your requirements from both a financial but also an operational perspective. It will also help if they can understand your key objectives. Because leasing can be moulded in so many ways to match a very wide variety of needs, you should always ensure that you have explored all of your current needs and any possible changes you can anticipate over the upcoming period. So keep these early conversations with your financing partner open as possible.
Starting the conversation early, and then working in close collaboration with your chosen partner, are central to getting the most from the innate flexibility of lease finance. But what you have to do first is to select a partner you can trust, and who understands your organization and its needs.

Fujitsu Financial Services Solutions

Financing is central to your IT financing decision. And choosing the right partner is the first step. Fujitsu Financial Services is the financing partner of choice for many organizations

Fujitsu Financial Services is the leasing and financing organization within Fujitsu. With our unique and tailor made financial solutions we address shrinking budgets, transfer technology risk, and disperse financial risk to help you acquire tomorrow's technology today.

For international corporations, medium-sized firms, small partnerships or the public sector, the freedom to spread costs over time helps improve liquidity and allows you to maneuver within your budget, enabling you to acquire a bigger solution than you could afford with an outright purchase. Financial solutions can help create budget where none existed, turn upfront costs into affordable payments, protect against technological obsolescence and disperse financial risk.

We will work with you to create a financial solution that is customized to meet your individual requirements and that covers the entire lifecycle of your Fujitsu investment. We give you a peace of mind, leaving you to concentrate on your core business.

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