

# Strategic Advisory

## Ten non-financial uses of IT leasing

IT shops are increasingly using IT leasing for operational reasons, as opposed to purely financial ones. Gone are the days when leasing was simply a 'buy versus lease' decision. It has instead evolved into a tactical tool in the hands of the savvy IT manager. IT executives have the difficult task of ever-migrating to ever-better technology, while at the same time keeping the production engine humming.

While no operational initiative is ever completely 'non-financial', the ten initiatives listed here are important mainly because of their operational benefits to an IT organization.

## Short-term test systems

Many of our customers are using very short-term leases to essentially ‘rent’ test systems for pilots in virtualization and server consolidation projects. A typical scenario might be a one-year lease for a used iSeries system, on which VMware is being used to test server consolidation scenarios. The ability to get in and get out of the gear quickly and easily at the end of the test/pilot period is important.

## Staging systems

This is similar to the above, but is used after the test period and only as a transitional platform. Again, to use the above example, a company might do one-year leases for small iSeries boxes at different locations around the company, to consolidate the servers in each specific location in the first phase of the initiative. Then, once the servers are consolidated within the various locations, these smaller iSeries boxes are migrated and integrated into a larger system at the central site in phase two. At this point, the smaller iSeries systems are no longer needed. The ability to turn them back in is important to the ROI of the project.

## Compliant disposal of small assets

Disposal of user-level assets (eg PCs, laptops, PDAs, monitors) has become an increasingly expensive and legally sensitive task recently. IDC estimates that labor costs alone are in the \$200-300 range per asset for standard disposal processes. The progressively difficult legal and PR environment, however, has raised those costs (and attendant risks) considerably. Most corporate disposal processes (geared for disposal of furniture, fixtures, and other durable goods) have typically not been upgraded to the required level of legal protection required today. Data privacy non-compliance can be exceptionally expensive today and companies are looking to large-scale

lessors for ‘industrial strength’ (and legally certifiable!) disposal practices.

## Emergency tech refreshes

Many firms have been caught in the ‘we need to use these assets one more year’ problem for several years. The technology on the desktop, in the closet, and in the briefcase has gotten stale, expensive to support, and a dead-end proposition for incorporating newer add-ons.

Much of this non-movement, of course, was required by the economic climate and/or the firm’s financial health/strength. Once the situation has improved, IT management must find a way to rapidly flush out the old technology and bring in newer technology en masse, while trying to minimize the substantial cost associated with such an ‘emergency’ transition.

Large, successful leasing companies have programs that include ‘buy up’ of older technology, as part of a leasing program for the new gear. [An exceptionally important version of this is where the company has its own products running on company-owned IT equipment at their customers’ sites. When a major upgrade in their product functionality is ready, and requires updating all the customer equipment en masse, this is a perfect time to use an IT leasing program for refresh.]

## Managing around yearly expense caps

Many large-scale IT projects have high up-front costs. For example, retrofitting warehouses with wireless capability can be very capital expensive. Budget processes often have yearly capital or expense ‘caps’ which make it very difficult for IT to be able to get all the requisite equipment up-front. For example, it may require \$500k to install wireless capabilities in several warehouses, but if our financial policies won’t let IT spend but \$250k per year,

the project cannot achieve its ROI. To buy half of the gear (typically unusable for ROI achievement purposes until all of the gear is installed and operational) the first year, and the other half in the next budget year, is wasteful, frustrating, ROI-delaying, and technologically risky. Leasing allows the IT manager to get all the necessary equipment up-front, so that the ROI stream can start ‘paying for it’ sooner.

## Emergency budget overruns

Occasionally, our forecasts of needed capacity for production and for growth fall drastically short. Partially completed large-scale projects can unexpectedly surface additional requirements which might double or triple the assets required. The more important the project is, the less likely the business can abandon the project (eg ERP). This creates the situation where the assets needed to complete the project and create the ROI/payback stream are simply out of reach of the IT budget.

In small budget overruns, IT typically will ‘eat’ them and cut other areas temporarily. When a large investment project goes over budget by factors of two, three or four times, this is simply impossible. Leasing is one of the few ways of being able to support the success of these projects without impacting a firm’s capital and debt structures adversely. [We have seen ERP implementations that were forecasted at 80-100TB data storage, grow to over 400TB in requirements—a four or five times overrun.]

## Interim architectures

Our tech refresh cycles are not always in sync with the technology being produced by the marketplace. We may be due for a new laptop upgrade, for example, 12-18 months before the new wireless capability we need will be widely available. Some of our installed base can wait and some can be upgraded ‘in place’ in the future,

but some of our older installed base may need new systems now. They need an ‘interim architecture’ (to be kept for only 12-24 months) to tide them over until the new technology can be implemented. This ‘interim architecture’ is specifically intended for a short window, and needs to be decommissioned at the end of that window. Buying makes no sense for such a scenario, but leasing might make great sense.

## Better bargaining power over suppliers

Many firms lease equipment from the leasing arms of the equipment manufacturer (called captive leasing companies or captives). These captives offer low rates and facilitate the sale of their parent’s equipment. The problem for IT comes, sometimes, at the end of that lease. The captive will sometimes use their position as holder of the assets to ‘encourage’ the customer to stay with the parent’s brand, even when the customer might want to change architectures and/or change vendors.

Since the customer typically does not have a way to recover any investment in the off-lease gear (eg they have no channels to remarket the used equipment and recover some of their investment), their only perceived option is to get some form of ‘trade in’ value. It is either lose everything or stay with the brand.

On the other hand, if the equipment is leased from an independent leasing company with a successful remarketing service, then the customer now has some leverage and bargaining power with the vendor. This allows the customer to switch architectures when necessary, but also gives them more clout at the bargaining table with the vendor, even when the customer doesn’t actually intend to change architectures. This can represent a huge shift in the balance of power between IT and their vendors.

## Architectural loss containment insurance

In spite of our best research, design, testing, pilots, planning, and implementation efforts, some projects just fail, and the equipment acquired for that project becomes useless for the firm. The technology might be ‘best of breed’ and market-accepted, but (as we found out too late) it didn’t match our specific business requirements well enough.

If a firm had purchased this equipment, then they are out 100 percent of the capital cost of that equipment, plus all the back-end disposal costs. If, on the other hand, the gear was leased through a savvy leasing company, the client would typically not have paid for 100 percent of the costs because the lessor would have put some investment into the equipment. If the lease terminated abnormally, the company still has to pay its large percentage, but this percentage is not the 100 percent, and this expense does not contain disposal costs. The lessor often has remarketing capability to fall back on to help recover its investment. The net effect is that the ‘loss’ to the customer is decidedly less in the leasing situation than in the buying situation, and the leasing program was the ‘insurance’ to allow some loss containment to be achieved.

## Chargeback structures

Many firms require IT to chargeback some (or all) of the IT budget to the business units they support. Chargeback schemes vary greatly, with costs being allocated back based on different ‘bases’:

- number of employees
- number of desktops
- assigned IT asset worth (eg cost of PCs/servers)
- assigned IT labor resources
- BU revenue
- BU budget dollars.

One thing is common to all approaches — all users disagree with them. They argue over what is a fair allocation, what their PC is really costing, and how much support they are really getting. Leasing of distributed/end-user assets can at least rationalize the allocation of PC asset costs (and therefore present a better ‘defense’) to the business unit users.

When you are paying a leasing company exactly \$XX per month for a leased asset, it is easy to defend that number (plus some management markup percentage) to the actual user. These are hard costs rather than ‘funny money’ and can help the IT manager defend the numbers more effectively, because a large chunk of the allocated cost is without dispute.

## This is not your father’s lease

There are the traditional financial benefits available in leasing. This paper has identified ten operational situations where a well-structured lease, with a savvy, independent, flexible, and financially strong leasing company makes excellent sense. Some of the situations described above would presumably require leases that are at some incremental premium or cost over a traditional cost of purchase, but the operational benefits—only available with such leases—are what that small premium is paying for.

Successful companies seem to recognize that ‘you get what you pay for’. Last year, customers leased over \$10 billion worth of IT assets—and not because it was always ‘cheaper than buying’. Rather, the operational benefits (some of which were described above) are becoming the drivers for IT leasing decisions today.

Lease versus purchase will still be a viable approach in some cases, but the operational benefits are quickly overtaking the financial criteria in leasing decisions for IT.

Macquarie Equipment Finance stands ready to partner with you in assessing architectural and operational options, and smoothly implement robust, safe, and savvy solution sets for achieving your organizational goals and mandates.

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