

# Strategic Advisory

## International IT asset management: complexity, challenges and contemporary approaches

The last decade has seen an amazing growth in multinational companies. Advances in information and communications technologies, expansion of international financial markets, and stabilization of global supply chains have created significant financial advantage for firms — as long as they can manage the scale, complexity, and incessant change. This has attracted investment, stimulated industry consolidation, and created intense competition from not only multinational companies, but even those based in a singular geography.

The economic power of large multinational companies is impressive. For example, the corporations named in Fortune magazine's 2004 'Global 500' had a combined asset value of \$60.8 trillion and gross income (revenue) of \$14.8 trillion. By comparison, world GDP in 2004 was only valued at \$40.9 trillion (World Bank).

The market power of these scale advantages is also accompanied by many challenges—one of which is the increasing complexity in asset financing and management. Subtleties exist in all aspects of this challenge: legal, currency, risk, organizational—to name a few.

This paper surveys some of the more pressing operational challenges and identifies the tradeoffs within the options available to large multinationals.

## Regulatory issues

### Changing standards

The asset financing, leasing, and reporting worlds are in major flux at this time. For example, the FASB and IASB bodies have been formulating changes to the accounting definitions of several financing instruments (eg changes to FAS 13 and IAS 17). At the same time, various countries have been reviewing and updating their internal taxation and legal standards.

International adoption and enforcement of the standards (eg IAS, Basel) by individual countries is always a 'work in progress' and large asset holders/procurers must anticipate changes to minimize negative impact.

The proposed changes to lease accounting advanced by the IASB and FASB are still in flux, and could have considerable impact on IT asset financing and management. These changes, in addition to the regulatory controls being developed and mandated to help protect the global economy from another meltdown, have uncertain timelines and unclear consequences for asset finance.

Apart from the critical financial impact of such complex (and sometimes rapid) changes, the operational impact for a multinational can also be significant. For executives, tracking these changes within all impacted geographies can require heavy expenses for legal, taxation, and accounting labor (or for outside expert services). Furthermore, management would also need to enhance their risk mitigation processes to address all the possible scenarios.

## Risk issues

### Political and business

Many revenue-focused business units in distributed geographies look like 'stand alone' companies, operationally. They start out small, serve local markets, try to establish market presence/power, and adapt to the local business and regulatory environment. They have advantages over true start-ups in that they often have access to scale-capital, established brands, institutional knowledge, and existing supply chains.

They still have a different risk profile than a new branch office in the country of their home office. They can:

- fail to achieve targets
- lose support of home office
- suffer unavoidable damages
- become the targets of debilitating legal or public outcry.

In such cases, investment in equipment/capital assets is at risk—due to probable closure of the business unit. Some leased assets can be returned through early termination processes, but assets purchased with either cash, debt, or equity could become a major drain on financial results.

Production/manufacturing facilities are less subject to local market conditions (apart from labor costs) since they are typically more asset intensive than sales offices. If they are compromised, the balance sheet impact can be worse.

Adjusting capitalization methods to risk profiles is nothing new. In a situation where business risk (not to mention the obvious political risk in some of these geographies) includes a significant asset investment, financial executives need to consider their exit strategies—before making final decisions on financing methods, hedging tactics, and insurance arrangements.

## Operational issues

### IT systems coordination

Fifteen years ago, it was commonplace for business units in different geographies to each have their own IT architecture. Due to various industry, regulatory, and efficiency factors, it was often better, cheaper, faster to have unique architectures by country. Telecom regulation was a big factor in this, as were vendor market power and skilled labor availability. Though it was typical to consolidate production and financial data for management functions, it rarely occurred in real-time and never with the capability to influence business processes in real-time.

This has changed dramatically in just the last ten years. Communication technologies, lower-cost distributed systems, and modular software design first created the capacity—which quickly became a 'strategic necessity' for globally-linked information systems. From extranets and eSCM systems, to ubiquity of broadband communications (both wireline and wireless), to electronic business process interconnects and executive 'dashboards', the technologies emerged and coalesced to make real-time information flows immediately actionable. IT-enabled change became so rapid that the 'near future' in 'Internet time' began to mean 'last week'!

IT assets require special planning and coordination because modern systems are extremely multi-vendor. It is not at all uncommon for a well-designed architecture to include products from 40 to 50 manufacturers, with 5 to 10 of those being major industry leaders (eg IBM, Cisco, EMC, Microsoft, SAP, HP, DELL, NEC, CA, Sun, AT&T, BT, etc).

For global architectures, this product fragmentation renders the individual product vendors' specific financing and/or asset management services (which are often further fragmented by

the suppliers' geographical divisions) of marginal use—and in some cases, even counterproductive.

To a CIO, this represents a complex systems architecture design, a large scale logistics coordination, and a tech refresh timing challenge of global proportions. To a CFO, this means sourcing and timing of multinational financing (as well as hedging) and asset management—also of global proportions. With a large amount of the asset investment in distributed assets (low-value, high-volume transactions), the administrative and lifecycle costs can be staggering.

### Centralization and consolidation

Centralization of operating processes and consolidation of suppliers are some of the first tactics undertaken to lower costs, improve process quality, and reduce risk. The generic advantages of these tactics map quite well into lease-type financing of IT assets in multinational situations. These advantages can be summarized easily:

- centralization of the entire business allows creation of equipment standards, standard operating procedures, streamlined support processes
- consolidation of suppliers allows creation of standard contract forms, terms and conditions, lower interface and liaison costs
- centralization of procurement along with consolidation of suppliers produces greater leverage with the vendor due to higher volumes — potentially lowering costs, increasing service, and integrating processes more tightly
- consolidation of suppliers lowers administration costs and allows more bulk-scale transactions
- centralization of acquisition and financing reduces the internal staffing and support resources required in the various business

units/geographies (lower headcount, higher quality)

- centralization of logistics (in the case of IT assets) allows more effective control of disposal processes and risks
- centralization and consolidation typically result in lower overall transaction cost, due to a 'thinner' administration cost load
- centralization of asset management processes can sometimes reduce support, refresh, and even unnecessary procurement of duplicate equipment costs, due to system-wide visibility into assets in the field.

Most of these advantages would also apply to single-country operations, but the issue of reduced resources in the various geographies has special relevance in this case. It has been commonplace for financial executives to complain that local financing, leasing or procurement by individual business units in the various countries is very inefficient resulting in lower leverage with suppliers, higher prices, less uniformity of supply, higher transaction costs, duplication of personnel, lower experience levels, and, occasionally, adverse tax and legal complications.

### Contemporary approaches to these challenges

Given the advantages and competitive necessity today of centralization, organizational approaches can be divided into three options plus a BPO (business process outsourcing) option. These options are differentiated by the structure of the financing and service delivery entities and by where the expertise resides for tracking the regulatory, accounting, and other changes in world markets.

### Option 1

The baseline—a centralized in-house organization which uses and manages multiple equipment vendors' financing arms and is staffed with internal experts and analysts (or 'rented' experts from the large accounting/consulting firms) who keep current on world financing regulations. This is probably the dominant model today, but only because newer options have only just recently emerged and proven successful.

### Advantages

- 'Only game in town' for decades, with well-established, mature processes and procedures
- Equipment manufacturer profit can sometimes be 'used' to subsidize financing rate
- Equipment manufacturer internal organizations can sometimes be used to manage around various cross-border commerce/capital challenges

### Disadvantages / risks

- No vendor consolidation benefits (eg no economies of scale available in such 'fractionalized volume' scenarios, high staff requirements to administer contracts with many IT suppliers, frequent coordination problems)
- High expert/analyst costs to track world changes
- Manufacturer finance organizations are often fragmented themselves
- No synergies between IT equipment financing and other, non-IT capital financing (ie manufacturer finance arms will not typically have the resources, expertise, or even enthusiasm to finance real estate, plant build-outs, acquisitions, business expansions, etc).

## Option 2

A centralized multinational firm, using a single geography finance company with a multinational 'program'. In this approach, a large well-run international company has a successful and satisfactory relationship with a geo-specific financing firm, and has influenced/convinced the financing company to develop operational capabilities and requisite legal expertise in other geographies. The finance company typically places personnel in the other countries, and manages them from the home office. The finance company sits between their client and the various IT equipment/product manufacturers (being independent of manufacturers itself) and provides consolidated pricing, administration, asset tracking, and various lifecycle services.

This model is somewhat common today and is a consequence of the rapid growth in demand for multinational IT financing/leasing. For example, leading independent lessors in the US will advertise this capability on their websites and in their marketing materials. They will describe some customer situation in which their customer needed overseas financing capability, and will describe how this need was met by hiring or transferring personnel into the other geography.

### Advantages

The advantages of Option 2 mainly flow from the benefits of existing relationships and general leasing theory.

- Established, successful relationships often cost less to extend into more service/product areas (ie leveraging existing systems, shared 'political investments', speed of change can be higher)
- Increased volumes with the leasing firm can lead to greater client 'power' over the financing firm, potentially yielding better pricing, service concessions, shared systems costs, and process customization

- The finance company—assuming it offers more financing services than just leasing—might be effectively leveraged for other non-IT financing in those geographies
- Manufacturer independence can increase negotiating power with equipment suppliers and make 'best of breed' architectural components more accessible to IT management.

### Disadvantages / risks

The disadvantages of Option 2 stem largely from the 'start up' nature and risk of such a venture.

- The geo-specific company has to acquire considerable expertise in a foreign jurisdiction rapidly—and more importantly—accurately for this to work
- The relative immaturity of the administrative operations within the remote geography
- Time and process requirements to get local permits, approvals, compliance requirements, etc.
- New relationships with manufacturers often must be forged within the specific geography
- Need to establish working relationships with other business, trade, banking, and government entities within the jurisdiction
- Risk associated with very small scale operations in foreign sites
- Unforeseen operational threats from within the new geography.

## Option 3

A centralized multinational firm partners with an existing centralized multinational finance/leasing company, with operations already established and stabilized within the desired new geography. The international finance company sits between the client/customer and the various IT equipment/product manufacturers (being independent of manufacturers itself) and provides

consolidated pricing, administration, asset tracking, and various lifecycle services—throughout the desired geographies. This model has only recently emerged—having grown out of aggressive international financial services firms' response to the new complexities in world asset finance.

### Advantages

- The advantages of Option 3 derive from the standard benefits of working with established, peer-sized multinational firms and from the infrastructure requirements needed by those firms to maintain their value proposition for customers
- Standard scale/size values of large multinational firms—good pricing, ability to invest in customization, stable/mature organizational processes, lower costs of capital, successful cross-border trade processes, etc.
- Experience and expertise already 'in stock' due to competitive necessity of such firms to stay on top of global changes in finance legislation, accounting, and taxation – for their own business model requirements
- Shorter implementation times, due to established business operations, local relationships, and political savvy in desired geographies
- Faster, easier, less costly expansion into additional territories, if/when the need arises
- Potentially lower transaction costs due to scale and one-company internal economies
- Access to global secondary markets—in the case of asset leasing operations—yielding lower financing rates
- Ability to leverage financial strength for non-IT financing needs
- Ability to create, fund, and manage a multinational tech refresh process
- Systems support for growing anti-terrorist mandated reporting

regulations, as well as for multiple languages, currencies, and (often) native scripts

- Sufficient size and enthusiasm to lobby for a pro-customer, pro-leasing legal environment in the various jurisdictions (eg the various efforts by the major leasing trade groups to protect the ‘balance-sheet friendly’ operating lease option from over-restriction or even from extinction).

**Disadvantages / risks**

Option 3 disadvantages derive from the newness of this organizational form.

- There are currently very few players in this space since the investment in expertise, established geographic offices, and scale capital limit how many financial firms in the world can even develop this offering within their member companies
- As peer-companies, negotiations are more at parity (as opposed to between a large client/customer and a smaller finance company)—although this is generally offset by the scale economies of consolidated volume
- Due to the experience of this kind of firm, they might not enter into some geographies because of risk exposure reasons. Conversely, an Option 2 leasing company might be willing to undertake the venture (due to the power of the client-customer relationship), but this ‘bravery’ is a double-edged sword.

**Option 4**

BPO outsources the entire procurement, asset management, financing and administration process.

This is mentioned here for completeness, although it is not yet very visible in the multinational IT asset finance area. In this scenario, the front-end processes are outsourced to a BPO firm which makes its own decision between Options 1, 2 or 3—with all of it (theoretically) transparent to the client company.

The advantages and disadvantages/risks accrue to the BPO firm, with the client company paying them for exploitation of the advantages and for minimization/containment of the disadvantages/risks (typically through a management overlay fee or shared cost/profit model). Although BPO is on the rise in the US, its usage currently is focused generally on domestic-only processes.

We might recap the central aspects of these options this way:

Option	Advantages	Disadvantages / risks
Direct financing relationships with individual IT equipment vendors, in various locales	<ul style="list-style-type: none"> <li>• Familiar</li> <li>• Process in place</li> </ul>	<ul style="list-style-type: none"> <li>• High administrative cost</li> <li>• Few economies of scale</li> <li>• No non-IT synergies</li> </ul>
Local leasing/financing partner, creates new geography ‘program’	<ul style="list-style-type: none"> <li>• High client power</li> <li>• Established relationship</li> <li>• Possibly greater customization</li> </ul>	<ul style="list-style-type: none"> <li>• High risk as a ‘start-up’</li> <li>• Longer ramp times/costs</li> <li>• Process immaturity risk</li> </ul>
Multinational leasing/financing firm	<ul style="list-style-type: none"> <li>• Operational maturity</li> <li>• Lowest risk</li> <li>• Adaptability to geochanges</li> <li>• Fastest ramp-up</li> </ul>	<ul style="list-style-type: none"> <li>• Less market selection</li> <li>• More peer-like balance of power</li> </ul>

**Conclusion**

There is an old management saying that goes like this: ‘There are only two kinds of problems ... problems from growth and problems from liquidation. Take your pick.’ Executives who are growing their multinational operations know that challenges are ever-present, and that cross-border asset financing/management is only one of them. Careful evaluation of these approaches and options just might lead to a reduction in the amount of management attention needed for the problems discussed in this paper — allowing more focus on other, perhaps more strategic, challenges.

As always, we at Macquarie Equipment Finance stand ready to leverage our international expertise, locations, systems, and organization to help you grow, fund, and manage your multinational business.

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