

# Strategic Advisory

## Reasons to choose an independent lessor

There are many solid business reasons why companies use a vendor independent lessor rather than a captive lessor (a leasing company owned by or completely aligned with a hardware manufacturer). Many firms consider these to be the top three reasons.

### **An independent lessor can help lower hardware prices.**

Captive lessors have their leasing rates subsidized by extra profit margins in the hardware. These extra margins are often used to make the leasing rates look competitive and actually are available to the customer—if they know to explore them. The hardware manufacturer can either give the extra profit margin to the customer (good) or to the captive lessor (bad).

An independent lessor can help customers pursue these extra profit dollars for a lower negotiated price.

### **An independent lessor on site is a continual reminder to vendors that they must be competitive.**

Some companies who use captive lessors will still lease part of their equipment with an independent lessor like Macquarie Equipment Finance—just to keep their ‘option’ in the face of their equipment vendor.

### **An independent lessor reduces the pressure to conform to equipment manufacturer product cycles.**

Equipment vendors have business models that require customers to refresh their equipment ‘in sync’ with

their product introductions. However, large enterprises normally cannot move so quickly, and sometimes even plan to skip a generation in some areas of technology. While the captive lessor will try to push the timing when equipment is refreshed toward the manufacturer’s cycle, independent lessors will focus on the customer’s needs.

## Vendor/captive and independent lessors

In the IT equipment leasing market, there are two types of lessors: vendor/captive and independent.

**Vendor/captive lessors** are financial services organizations that are owned by an equipment manufacturer with the primary goal of facilitating sales of the parent's equipment. Because these lessors are tied directly to the parent's business model and equipment sales goals, they are often called 'captive leasing companies' (or just 'captives'). Though captives sometimes generate profit from a financial services perspective, their primary objective is to generate profit for the parent by increasing equipment sales. Captives have played a large part in IT equipment leasing over the years (especially in the early days of technology when IT architectures were dominated by a few large manufacturers), and have helped many companies (especially smaller firms) procure large amounts of IT assets to manage their business.

**Independent lessors**, on the other hand, operate autonomously from all manufacturers, and have no particular commitment or allegiance to vendors. They exist to make a profit strictly from financial management, asset management, and used equipment markets. As a result, they are able to treat all equipment equally and have no interest in pushing one brand over another.

These two different business models and goals—facilitating the sales of a brand of equipment versus facilitating the sales of any brand of equipment (including used equipment)—gives rise to a number of distinctive situations in which independent lessors could better serve an enterprise customer.

## Financial benefits

### Lower equipment pricing through historical pricing data

An independent lessor can often provide a customer with 'street pricing'. Macquarie Equipment Finance—one of the largest independent investment grade IT lessor in the world—bids on several billion dollars worth of IT equipment per year. These represent final, negotiated prices ('street prices') on major IT equipment types. Equipment manufacturers do not typically share this information with their customers as they are hoping to get the highest negotiated price to maximize their profit margin. Conversely, independent lessors have a vested interest in helping customers get the lowest price possible because their profitability depends partially on the sale price of the returned asset in the secondary/used market. An independent lessor will help customers negotiate the best price with the manufacturers, while captive leasing companies often will not.

### Lower rates through higher deal volume

An independent lessor has an easier time grouping multiple manufacturers' products—creating higher volumes—and therefore better leasing rates. Captive lessors can (and sometimes do) finance products other than their own. Captive lessors do not, however, have expertise in remarketing competitors' equipment. Therefore, captive lessors cannot provide the same blind discount pricing afforded to them by their parent/manufacturer to a competitor's equipment. When financing a competitor's equipment, the captive lessor's goal is to displace the equipment with their own during the primary term or when the lease expires. Many captive lessors have recently pulled back from financing competitors' equipment or are only doing so at much higher pricing. Independent lessors, on the other hand, can provide lower rates by

aggregating technologies, software, and services from multiple vendors into higher volume transactions.

### Practical source of used equipment for special requirements

Independent lessors are often eager to sell quality used IT gear, at very good prices. These are typically off lease assets and are often recertified by the manufacturers for service and maintenance. Such units can help a company save money in situations of disaster recovery plans, data center migrations, test systems, and spikes in demand. In contrast, equipment manufacturers (through their captive finance company) tend to steer customers toward their 'latest and greatest' (often a euphemism for 'most expensive') new models. The independent lessor, on the other hand, seeks to build its profit models as a result of reselling used equipment in the secondary market. This creates an incentive for the independent lessor to offer customers attractive pricing, terms, and service options on the refurbished equipment—with the customer being the beneficiary. As a result, customers often save considerable cash by utilizing refurbished equipment for special projects.

### Lower costs through better information on in-place upgrades and alternatives

Because the independent lessor's profits are partly tied to its ability to resell used equipment, they have a vested interest in extending the useful life of an existing asset as long as possible. Independent lessors will try to make in-place upgrades as easy and as inexpensive as possible for a customer. In comparison, captive lessors are less interested in providing in-place upgrades and more interested in getting the customer to migrate to new products. However, as anyone in IT will attest, in-place upgrades of production equipment are almost always less painful than are full, 'forklift' replacements of old to new

equipment. Since independent lessors are generally more willing than captive lessors to discuss a customer's in-place upgrade options, this can save the customer considerable time, money, and disruption.

### **Greater transparency of the actual cost of equipment**

With an independent lessor, customers can generally tell the interest rate they are receiving. This is frequently not the case with the vendor-owned lessor. Because they are subsidized by extra manufacturing discounts (ie blind discounts), their 'low rate' provided to the customer is not the 'real' rate. Since this gap between the actual and the quoted/estimated rate is being paid by the manufacturing parent, the customer might actually pay a higher interest rate to the captive lessor than they would with an independent lessor.

Unfortunately, this means the captive lessor's leasing rate is being bolstered by extra manufacturing profit that the captive lessor's sales representative did not provide when negotiating the equipment cost with the customer. So, not only is the customer not getting the best discount on the equipment, some of that extra profit is being used to 'hide' a higher leasing rate.

The ideal situation for the customer is to have complete transparency into both the actual cost of the equipment (including any discounts) and the leasing costs. To accomplish this, a customer needs a breakdown into two separate quotes for:

- the equipment costs (including any discounts)
- the lease rate based on that equipment cost.

With these two sets of numbers, independent lessors like Macquarie can often provide the customer with more detailed information about leasing and equipment costs and how much money was left on the negotiating table.

By using known ranges of intra-company 'subsides' granted by a specific vendor (and with a quick look at any captive lessor's published return-on-equity results), a Macquarie analyst can estimate the additional discount a customer should request — and show them how to accurately compare the two actual leasing rates.

## Equipment vendor relationship benefits

### **Better leverage with vendors at lease end**

An independent lessor can also provide assistance to a customer when negotiating with the equipment manufacturers at the end of the lease. Too often, the captive lessor has the power to 'punish' a customer for switching vendors and swapping out a technology that is currently installed and owned by the captive lessor. The captive lessor has a vested interest in keeping the equipment footprint in-place and will leverage their ownership and end-of-lease handling and processes to steer the customer in their direction.

In contrast, an independent lessor has no vested interest in which technology a customer chooses—as long as the technology is good technology and has value at end-of-term. As such, independent lessors place no obstacles in changing from or staying with a particular equipment manufacturer. This provides customers with a stronger position with vendors at the negotiating table.

### **A check on vendors so they have to remain competitive**

Similar to the above point, some companies lease equipment from a combination of captive and independent lessors, in part, to help keep the captive lessor's rates competitive with the market place.

It also keeps the customer's options open in the face of their equipment vendor. For example, it is very common for a customer who leases several mainframes from a captive to also lease a third of them from an independent lessor. This serves as a check on the captive lessor when it comes to service, pricing, and negotiations as the customer has other options at its disposal. Using an independent lessor like Macquarie can also help increase a captive lessor's responsiveness when services are needed.

Many clients have also found that pricing on the replacement equipment is more competitive when a third-party lessor is involved. Using an independent lessor forces vendors to play on an equal playing field and prevents vendors from controlling the customer's equipment replacement strategy. In the long run, this should save the customer money, time, and management attention.

### **Less pressure to conform to equipment vendor product cycles**

Independent lessors are more focused on the customer's refresh cycles, rather than the manufacturers' product cycles. On the other hand, equipment vendors have business models that require customers to refresh their equipment 'in sync' with their product introductions. Large enterprises normally are not able to move as quickly to the latest product introduction, even with a common practice to 'skip one generation' in some areas of technology. The captive lessor will try to influence customers to the manufacturer's product cycle, whereas an independent lessor has no need to push the customer in this direction. Independent lessors support the enterprise customer's needs as their requirements change.

## Business efficiency benefits

### Greater freedom to select alternative architectures

Independent lessors are respectful of an organization's IT architecture wishes and so they would not apply political pressure on the IT department to select a 'middle of the road' solution, when a 'best-in-class' solution is needed.

There are times when IT has accepted a 'good enough' product in light of superior support or easier integration or management. Many IT executives have had the unpleasant experience of choosing a new vendor for laptops or x86 servers, only to have some incumbent mainframe or Unix-server vendors make extreme pricing concessions on their products to the CFO at such a level that it creates tremendous political pressure on IT to settle for less. This is not an infrequent situation and is one that can be countered somewhat by having the independent lessor own the older assets. Independent lessors can sometimes increase the opportunity for IT to get their architecture choices implemented, rather than those of some manufacturer.

### Centralized multi-vendor asset information systems

Due to the nature of their business model, independent lessors generally must have asset tracking and reporting capabilities. These tools and systems can prove to be of great value to customers. For example, Macquarie has a robust online asset database for its customers, allowing them to manage equipment from multiple vendors. Serial numbers, cost centers, equipment location, termination date, and other data are provided in one centralized location for review, reporting, and download.

Additionally, many clients are uncomfortable with captive lessors managing their asset tracking system because the captive is able to view

other vendor equipment and develop a sales strategy to replace this equipment. As an independent lessor, Macquarie manages technology assets impartially.

### Consolidated lease vehicles for competing technologies

Independent lessors have no problem combining technology competitors onto a single lease structure, whereas captive lessors might make the process a bit more cumbersome and complicated. For example, to lease one vendor's software on a competitor's hardware is simple to Macquarie. This same request may require additional (or even parallel) paperwork processes with a captive lessor as well as possibly require a two tier pricing model: one level of pricing for assets supplied by the first vendor and another level of pricing for assets supplied by the second vendor. Independent lessors simply do not struggle with this issue.

## Conclusion

For the enterprise IT environment, only a large independent lessor will have the scale, systems, experience, geographic reach, and rates appropriate to manage an enterprise business solution. Small regional independent lessors are not likely to have the same 'horsepower' to service the higher needs of the enterprise.

Similarly, vendors and their captive lessors are sometimes out of sync with the plans and needs of the enterprise customer. As one of the largest multinational independent lessors, Macquarie Equipment Finance has a solid balance sheet with an aggressive cost of capital which has been built and operated in such a way as to allow an enterprise to accrue and enjoy as many financial, vendor relationship, and business efficiency benefits as possible.

We at Macquarie look forward to providing our clients with a set of flexible, enterprise-savvy tools and structures that will assist them in leveraging technology in pursuit of their business objectives.

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