



## Towards a Benchmarking Tool: *Measuring the Performance of the Organization's IT Asset Finance Function*

### Introduction

IT finance managers have long had the basic tools for making lease-versus-buy decisions, even though those tools have become more complex over time. Most of this additional complexity arises from the lifecycle nature of IT assets (especially distributed assets such as PC's and mobile devices), in the form of Total Cost of Ownership (TCO) variables. Modern lease-versus-buy models include such variables and are beginning to incorporate risk factors as well (for example, the likelihood of early termination or lease extension).

But, the maturity of the buy-versus-lease tools and of the TCO tools is not matched by a maturity of tools to measure the performance of the lease operations function itself. Those professionals in our organizations who make these decisions, negotiate the contracts, manage the lease lifecycle, and retire the assets when finished often do so in the absence of methods to measure their performance and contribution. There are, of course, industries which are heavily dependent on leasing--commercial real estate, the airline industry, retail banking and the leasing industry itself for examples--which have developed rigorous performance measurements for lease operations, but nothing like this exists today for lessee-side IT asset finance operations.

Part of the difficulty of measuring performance in this space is that IT assets are **generally leased for other reasons than for simple financing**. Unlike commercial real estate and airplanes, IT assets are typically financed for process management and obsolescence-related cost avoidance.

According to a survey by *Global Insight* in 2004, the top five reasons for leasing PCs, for example, would not appear in most standard Lease-versus-Buy financial models:

Top Five Reasons for Leasing PCs*	
Discipline imposed on maintenance and replacement	cited by 65%
Protection against obsolescence	cited by 54%
Off-balance-sheet accounting	cited by 53%
Convenience	cited by 51%
Efficient use of tax incentives	cited by 36%

\*Based on Global Insight survey findings reported in "(Don't) Look Deep into My Lease," *CFO Magazine*, 07/01/2006).

Leasing as a way to be able to finance equipment is important to many firms, but most IT equipment leases (at least for distributed assets) are not the result of simple 'cost of money' comparisons--they are the result of strategic and operational management needs. Accordingly, measuring the performance of a lease operations function would include both measures of efficiency (such as transaction costs, throughput, and quality) and measures of effectiveness (such as process centralization or utilization of flexibility).

## **The Problem of Baselines**

The lack of mature measurement tools for lease operations (that is, what should we measure?) in enterprises creates a corresponding problem for setting objectives and targets (that is, what do we measure *against*? What performance *targets* do we aim at?).

There are no standards for how many assets-under-lease a Lease Analyst should be able to manage, nor any for staffing ratios of labor costs to assets-under-lease volume. And, most of the 'best practices in leasing' articles relate only to leasing as a financing tool dealing with cash flows. There are no commonly known approaches to measuring the effectiveness of leasing as a management tool, for example.

This means that we are basically forced into a baseline measurement approach. We have to:

- select some subset of the metrics discussed below (based on business impact and ease of measurement),
- take a baseline of our current state of performance, and then
- compare subsequent periods against that baseline.

Some metrics within the baseline will be targeted for improvement, and over time, new variables will be substituted for older ones--as our processes improve as a result of this measurement process.

So, the metrics offered below are a super-set of what an individual department would include in their initial baseline. Some of the variables will not be feasible to measure for some shops, while other variables might be of negligible value. But measuring the important ones--and discussing ways to improve those numbers--will be important to managing the Lease Operations function and important to communicating to senior management (and internal customers) that the Lease Operations function is being managed to the best interests of the organization.

## **Efficiency Metrics**

Efficiency metrics are generally about workload throughput, process times, quality, and transaction costs. Some of these metrics would apply to individuals as well as to the group as an aggregate.

Workload throughput measures would be calculated per individual and perhaps per labor hour (in the case where there are no FTEs dedicated to the leasing function). These are fairly straightforward in definition, but may require some manual recording at first. They would include:

- ❑ Leased asset acquisition ratios:
  - New serial numbers leased per calendar period
  - New assets leased per calendar period (Serialized and NonSer)
  - Asset dollar volume of new assets leased per period

- Leased asset return ratios:
  - Serial numbers retired per period
  - Assets retired per calendar period (Serialized and NonSer)
  - Asset dollar volume retired per period

Process time/turnaround metrics would measure how long a process takes and how that impacts other business processes in which it is embedded. Some of these can be used in individual performance, but some can only truly be assessed at the group level. They would include:

- Average time to add a new schedule to an existing Master Lease Agreement (MLA)
- Average time to create a new schedule from an approved request
- Average time to log an incoming asset onto a schedule (acceptance)
- Average time to remove an asset from a schedule (retirement)
- Average number of days to transfer end-of-lease (EOL) purchased assets into the internal financial system
- Percentage of procurement process turnaround required for the leasing component (for example, if the procurement process takes 10 days of processing from equipment request to equipment installation, what percentage of that time is used for leasing-related work)

Process/work quality metrics are focused on how well the overall processes work, when followed accurately. Some quality metrics can be impacted by vendor performance issues, but since vendor management is often a responsibility of this group, the metric can still signal the need for process improvements or management attention.

- Percentage of time spent on re-work due to internal problems (e.g., reentry, internal reconciliation)
- Percentage of time spent on re-work due to external vendor problems (e.g., reconciliation problems)
- Percentage of required notifications given on-time
- Percentage of EOT extensions *without* some per-unit explanatory documentation/notes (e.g. waiting on some external event, still evaluating what to do, end-user wanted to keep system) to demonstrate that oversight was not lacking in these cases. [Requires per-item process capability on the part of internal operations and external lessor.]

Transaction cost metrics focus on the ratio of outputs to departmental expense. The various output metrics are basically divided by the portion of the department budget that is estimated to be for the lease operations function. For example, if the procurement group is 12 people, and 3 of these are dedicated to lease operations, then we might use 25% of the aggregate department budget for the divisor (with some adjustments for compensation differences, if any). This does not need to be a precise number, but it must be 'conservative enough' to be defensible to upper management.

- Total assets under lease (units) divided by department expenses (relevant portion)
- Total assets under lease (dollars) divided by department expenses (relevant portion)
- New assets under lease (units) divided by department expenses (relevant portion)
- New assets under lease (dollars) divided by department expenses (relevant portion)

Process maturity metrics focus on the process *as a whole* (eg, process documentation, use of analytics), and on the process as a feeder/user of *other* processes (eg, service management, financial reporting). These can be more difficult to measure, but at least can be reviewed for awareness and planning.

- Process documentation: are the various workflows and transaction steps fully documented somewhere in a policy and procedure manual (as in ISO 9000 projects)? Are the descriptions fully detailed, so that no undocumented tasks are required for the process to be successful? Is each task/step in each process assigned 'standard' ranges of costs (e.g., \$/step, \$/transaction) and ranges of execution times (e.g., labor hours/task, calendar days for turnaround)? How often are these assigned variables reviewed and adjusted on the basis of current period measurements?
- Process compliance: is this documentation reviewed and audited regularly? How often does the process documentation require changing, and how are these changes initiated, controlled, recorded, and validated?
- Process uniformity: how much variance has been observed from the 'standard' process costs and execution times? How has this trended over the most recent few periods?
- Process interfaces: how well do the various interface mechanisms work between outside systems, such as asset registries, service management configuration management databases (CMDB), accounting systems, HR, lessor systems, contract databases, etc? This area would include measuring elements like number of interface transactions, number of transactions requiring manual handling, cost of maintaining the interface, number of transactions requiring re-work, and labor hours spent getting the transactions across the interface.
- Process improvement: what types of business analytics are used in each step of the process? Are there reports available that identify current opportunities for improvement in the various process steps? How often are the steps reviewed for improvement opportunities, on the basis of such reports?
- Process improvement: how often are the outside partners leveraged for process improvements? How often is the equipment lessor consulted on technology directions, pricing trends, vendor negotiation tactics, or alternative financial structures? How often are the business units consulted for suggestions on internal process or interface/interaction procedure improvements?

## **Effectiveness Metrics**

While efficiency metrics focus on how well we 'do things', effectiveness metrics focus on 'doing the right things'. In today's world, we have to divide 'the right things' into the things we must do (that is, compliance and organizational requirements) and the things we should do (for example, strive for process improvements or leverage vendor offerings to the fullest).

Under the 'must do' category, these would be significant:

- Compliance controls: how frequently are controls reviewed?
- Organizational support: percentage of resources used in supporting re-orgs (for example, in recoding leases when cost centers change due to re-orgs or adding assets from an acquisition)
- Records quality: How long does it take to retrieve a data-wipe proof document for a given asset tag or serial number?
- Records comprehensiveness: What percentage of retired assets do we have complete disposition records (including chain-of-custody and disposal certifications, where required) for?
- Business continuity: how often are succession, labor loss, and DR plans reviewed?

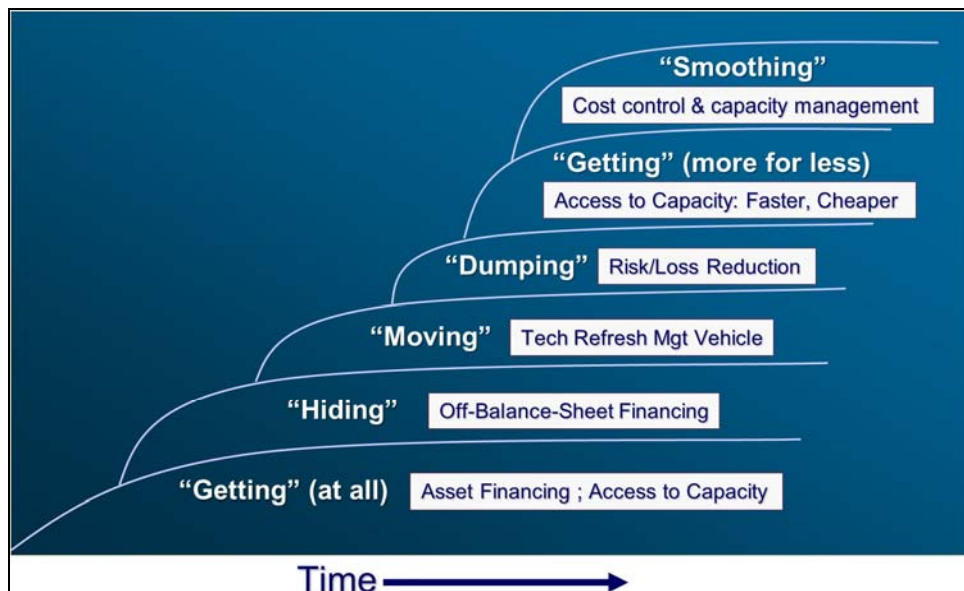
Under the 'should do' category, we have two sub-categories: *sound management practices* and *leasing-specific practices*.

*Sound management* metrics will focus on things like how well the department supports their customers, influences the business units, forecasts workload, and improves itself. Some of the measurements in this sub-category would include:

- Organizational cohesion: % of asset moves (and disappearances) which are reported to you by your business unit customers, versus % of assets that were moved without notification to you
- Organizational cohesion: % of EOT assets that cannot be located at all
- Organizational cohesion: Amount of leasing done outside-of-policy and/or outside of your (mandated) group? (in units and dollars)
- Organizational cohesion: Percentage of extensions due to customer requests (units, dollars)
- Workload forecast quality: how often do you meet with IT and business units to discuss future asset demand?
- Workload forecast quality: Staff-hours estimated for upcoming months, based on forecasted demand and on lease expiration forecasts, versus actual/historical.
- Process improvements: how frequently are MLAs reviewed?
- Process improvements: how many vendor quotes (with financing included) are not standardized on an 'unbundled' template? [Captive vendors and some systems integrators do this routinely-- quoting a hardware price to the customer much greater than what is actually sold to the finance arm for financing, making comparisons with other vendors and with independent lessors all but impossible. This reduces the opportunity for Sourcing to get the actual best leasing rates and the lowest product discount.]

*Leasing-specific practices* will focus on **how well we leverage the non-financial benefits of IT asset leasing**. As noted in the Introduction, most IT asset finance (of distributed assets) is done for reasons of flexibility, process discipline, and obsolescence cost avoidance. Metrics in this category will isolate and measure the utilization of those inherent benefits.

Another way to conceptualize this is to take note of **how the uses of leasing have developed over time**:



Asset financing ("Getting" the equipment) was the earliest use of leasing, but in the era of distributed computing and rapid technology innovations, the higher uses have become dominant.

Under *Leasing-specific practices* would be uses of leasing **flexibility** and **cost avoidance**:

- Flexibility utilization: Percentage of asset substitutions at EOL
- Flexibility utilization: Percentage of returns that are EARLY due to change of needs
- Flexibility utilization: Percentage of extensions/late returns due to simple convenience needs
- Flexibility utilization: Number of assets (and \$) within an asset class which are/were on leases of 12 months or less. These represent short-term needs (for example, staging equipment, interim architectures, transitional periods, test equipment) that could not have been addressed through purchase, and which addressed urgent business requirements.
- Flexibility costs: Any difference between planned and actual lease expenses (at some aggregate level), as an estimate of what the flexibility benefits 'cost'. In other words, any extensions or ongoing rental expenses--for the sake of flexibility and operational convenience--which exceed some estimated purchase cost (when adjusted for disposition costs and any other lifecycle costs) represent what you 'paid' for the *flexibility* of leasing the asset and/or the *management and process advantages* of leasing.
- This represents an identifiable cost savings, in the cases of unanticipated asset abandonment.
- Lifecycle/maintenance cost avoidance ("Smoothing"): Any known lifecycle costs for non-leased assets, normalized, and applied to similar leased assets. This is an estimate of what costs *were avoided* due to the tech refresh discipline. (Make sure the assets used for the baseline are comparable--especially in usage intensity--to the leased assets in the estimate.)
- Disposal cost avoidance (external): estimated savings from actual in-lease disposal costs versus market-based external disposal service fees, when adjusted for any economy recovery value, in both scenarios. (Make sure that the external prices used for benchmarking are comparable to lessor processes/services and comprehensive of all the tasks involved: De-install, warranty check, software recovery, data sanitization, parts harvesting, destruction-documentation, packing, shipping, chain-of-custody docs, secure transport, secure storage, insurance, remarketing, audits, etc.)
- Disposal cost avoidance (internal): same as the above, but when compared to internal labor costs for any of the disposition tasks still performed in-house. (Be sure to use fully-loaded costs for anything still done in house, including temp labor, payroll burden, facilities, tools, etc.)
- Risk/loss containment ("Dumping"): Difference between lease payments (plus any transition costs) and full acquisition cost for 'abandoned items'. This is essentially the difference between early lease termination and the (generally much higher) cost of 'eating the entire asset cost'. This is for the situation in which some asset has to be retired early, due to a change in business requirements or in economic situation.
- Risk/loss containment: In addition to 'eating' the book value of an asset which had to be retired early, we often have to replace the unit with a new/different one. This often occurs in a 'forced refresh' scenario: where systems must be *replaced* early, due to change in ISV support policies, forced compliance upgrades, or sudden architecture changes. The cost savings can be modeled on the basis of *percentage of assets which must be replaced earlier* than planned. A sample model can be constructed showing the break-even point between purchase and lease. Although leasing is generally less expensive from a cash-out-the-door standpoint anyway, *even in cases where there is a small premium over purchase costs, a forced refresh of as little as 2.5% of units can justify the premium*. Here is a sample model computed for 100 PCs with acquisition costs of \$800 and a leasing 'premium' of \$20--showing the breakeven point at between 2% and 3% of units needing replacement. If zero percent of units require early retirement, the 'premium'

totals to \$2K. But, at a 3% replacement rate, the \$2K 'premium' is offset by the full purchase cost of 3 units (\$3x\$800). Any 'premium' associated with early-return flexibility of leasing disappears quickly when compared to costs of replacing more than 2.5% of installed units.

<b>% Needing Early Refresh</b>	<b>Qty Replaced Early</b>	<b>Incremental Replacement Cost</b>	<b>Initial Savings of Purchase over Lease</b>	<b>Post- Replacement Adjusted Savings</b>
<b>0%</b>	0	\$0	\$2,000	\$2,000
<b>1%</b>	1	\$800	\$2,000	\$1,200
<b>2%</b>	2	\$1,600	\$2,000	\$400
<b>3%</b>	3	\$2,400	\$2,000	(\$400)
<b>4%</b>	4	\$3,200	\$2,000	(\$1,200)
<b>5%</b>	5	\$4,000	\$2,000	(\$2,000)
<b>6%</b>	6	\$4,800	\$2,000	(\$2,800)

There are two leasing-specific items which are more financial in nature:

- ❑ Strategic use of cash: Difference between new asset lease payments for 1 year and what those assets would have cost under a purchase scenario, when multiplied by corporate Return on Capital. The difference between the two represents--conceptually--how much cash the business could/should have invested, earning an ROE multiple of that. This one-year number could be adjusted by lease payment amounts from previous years' origination, but a model that includes those years would also need to include the ROE factors for the freed-up cash in those prior years as well.

And, of course:

- ❑ Basic finance savings: Lease-versus-Buy calculated savings for assets returned contractually. In most cases, leasing only costs more than purchase (for short-lived assets) when the flexibility features of leasing are used (that is, the asset is returned early or later, or rolled into a migration). But, when those features are *not* used--and the asset is returned on time and in spec--the cash outlay cost of a lease is generally less than that for purchase of an asset (due to the equity investment by the lessor). So, for many (if not most) of the IT assets leased, there should be a cost savings amount that is measurable. In the aggregate, some of these savings might be used to help 'fund' the flexibility benefits of other assets, but the measurement is still a good one--and it represents the original benefit of IT asset lease financing.

Some of the above flexibility benefits and costs should also be measured using a process-unit view, which would include the all-in costs for a lease lifecycle. In other words, at the end of a lease, the lease results should be accumulated and reviewed. Since much of IT equipment leasing is done for reasons of flexibility, we can expect that the components or items under a specific lease schedule might have different outcomes (ie, some items bought, some returned, some renewed in a new lease, some renewed on month-to-month basis, some substituted for other assets). It is not at all uncommon for a client to measure/estimate these all-in costs and compare that total to the final implicit rate. And, when all these costs are combined with equipment return services and the lessor's ability to perform data

destruction, provide pick up assistance etc, the 'pure' economics are still attractive--especially given this flexibility to manage the transition to a newer footprint and to achieve process standardization and control. Flexibility and cost management can both be improved under such arrangements.

### **Conclusion: A Practical Note on Measurement Costs**

An old management axiom states: "You cannot manage what you do not measure". Managing lease operations -- efficiently and effectively--requires measurement of important variables. Costs and outcomes, transactions and throughput, quality and forecast accuracy are standard management control indices for business practices.

But, measurement activities have costs too: design cost, recording costs, management costs, analysis costs. Some of the above variables will be difficult to find data for (at least initially) and some will require 'timesheet' type recording of labor usage (for periods of comparison). Some will require digging through IT support/maintenance records or investigating leasing process variants out in the business units. Some of the variables will end up not being controllable enough to warrant the measurement costs, and the impact of improvements in some specific variable may not justify the cost of even measuring that variable.

But, we do not know until we have done our first benchmark--even if that first benchmark is a 'rough cut' at the numbers. We will need to work through this list with leasing personnel and managers and identify the first 5-10 metrics to establish for our first baseline. We then apply standard process lifecycle approaches to our measurement process: measure, adjust, measure, adjust... When we have hit some limit of 'diminishing returns' on those variables, we then move to the next set of variables and repeat this process.

In some cases, our measurements will be 'occasional'--like an audit--and in other cases we can build the measurement task into the process and/or into the systems which support that process.

In all cases, however, we accomplish several major things:

- We demonstrate to senior management and to our constituency that we are actively managing this function;
- We inculcate a culture of accountability and improvement among our employees;
- We increase the business benefits we exploit from the IT asset leasing model.

We at Macquarie Equipment Finance look forward to working with you to measure and improve your leverage of our financial services offerings.