LEASE vs. PURCHASE: HOW TO CHOOSE

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EXECUTIVE SUMMARY

IT departments acquire computing assets in a nearly continuous cycle, replacing aging equipment and buying additional assets to suit the changing needs of their organization. In many cases, available cash funds and budgets impact making acquisition decisions at the optimum time. But this is an unnecessary restriction since attractive leasing options are nearly always available. Leasing is often the best option, since it allows your organization to keep its cash resources for other needs and spread the payment for new equipment, software, and services over the period of its usage.

For firms considering the lease option, IBM offers a better choice, with its vast financial resources, competitive interest rates, and its ability to structure a lease to suit a particular client and his situation. IBM can also offer lease clients flexibility, with equipment traded out or added during the lease, to suit business needs.

In this white paper we will explore the leasing option for technology asset acquisitions and IBM’s particular suitability to this market. We will also use several case studies to provide examples of how this works including the toy company LEGO and the telecommunications services provider, Packet One.

By the end of the paper you will be able to see the leasing proposition clearly and understand the advantage of doing business with IBM.

INTRODUCTION

In the current financial situation, organizations would like to use the slow part of the business cycle to update and refurbish their IT infrastructure. This allows them to move forward with competitive advantage as the economy begins to recover.

But CFOs and CIOs are concerned about how long a recovery might take and what their financial position will be in the meantime. This has led to many organizations deciding to hold on to their cash (“hoarding”) to insure flexibility. At the same time, credit requirements have increased, reflecting the banks’ uncertainty.

This is not a world-wide problem. In the emerging economies, sales are growing at a brisk rate and, in fact, many firms are like IBM with a majority of their revenue coming from outside the U.S.

In this time of uncertainty, customized leases represent a way to avoid front-end expenses for new projects and pay for new assets over a period of time. Companies can start renewals and new projects in IT without cash outlays.

ACQUIRING COMPUTING ASSETS

In all business transactions, the financial solution should fit the buyer. Each buyer is different. For example, if we have a $500 million company with 600 employees that manufactures and distributes automobile parts they might need an upgraded data base and a new inventory control system. The
transaction might be in the $300,000 range, involving a combination of hardware (computer systems and storage), software, and services. IBM could offer this potential lease customer a choice of financial solutions. The buyer might simply want to take the entire cost of the transaction and make it into a combined lease and financing structure, stretching his financial liability into 36 equal and predictable payments. Or the buyer might prefer to have a customized structure where payments are tied to the incremental value of the implementation (usually that means smaller payments in the beginning and larger payments toward the end but, all set out in advance and predictable for the buyer).

IBM Global Financing can always fit the solution to the buyer, regardless of the size of the buyer and the size of the purchase or the differing financial situations in various industries (some retail businesses do 75% of their annual business in the two months before Christmas). Some transactions are mainly about the acquisition of hardware, others may include software or services.

Software and Services financing have now moved to being more than 50% of new financing. The balance varies by country with the more developed countries having a higher percentage of software and services in their mix.

**EXPLORING THE LEASE CHOICE**

The main reason for selecting the lease option may be to conserve cash, but it’s just as likely to conserve flexibility, or being able to adjust the assets under lease during the term of the lease.

Many customers choose the Fair Market Value (FMV) lease, where the client pays only for the use of the equipment in exchange for lower monthly payments. With an FMV lease the client can choose to return, extend, or renew the lease or purchase the equipment at fair market value according to their needs. Clients who anticipate a longer useful life for the equipment or know that they will keep the equipment at end of lease can opt for a Full Payout Lease. Again, the object is flexibility, preserving the firm’s choices.

The real issue is Return on Investment (ROI). This is the value the firm will receive for its investment in the asset, regardless of whether the investment is in the form of a cash purchase or a lease. In calculating ROI (which every buyer will want to do) to compare apples to apples and not to oranges. For example, if by leasing you can upgrade your equipment every three years instead of every five years, you can anticipate having smaller administrative management and technical costs since aging equipment often requires additional support. Or, if by leasing from IBM you get a lower cost lease that factors into your ROI and will advance the time when you have paid off your investment and are gaining savings benefits sooner.

**WHY LEASING IS BETTER**

Leases are custom documents, designed to suit the Lessee’s needs. This might include the length of the lease, its start or end date, or the exact combination of hardware, software, and services it might include.
A real value of leasing is the flexibility it affords to the customer. Some of the advantages of the leasing choice include:

**Retaining Cash Assets for Other Uses:**

Leasing avoids using the organization’s capital to support its technology infrastructure requirements. Instead, it allows customers to use their capital resources to invest in their business for growth and new opportunities. Regulated industries may need to keep some of their capital in liquid form (typically a percentage of their assets); leasing rather than purchasing can free up capital to meet these requirements without preventing IT from meeting changing business requirements.

Leasing does not change the company’s available capital since no capital is being used. This can give the company a more attractive financial rating and allows for the possibility of qualifying for business loans without considering the impact of the technology purchase.

Leases may be structured to avoid large up-front costs such as the payment for hardware, software and services. Instead, the lease offers the lessee predictable payments, often with no down payment, spread across the life of the lease.

**Flexibility in Timing Technology Purchases:**

Leasing allows customers to buy new technology when they need it rather than waiting for resources to be available. It allows customers to move up the technology curve when their needs and business opportunities require upgrades and enhancements; many leases provide for upgrading within the terms of the lease. This allows the organization to meet its IT needs and remain competitive. In fact, flexibility in trading out equipment can drive lower costs and better IT utilization.

**IT Life Cycles:** Leasing makes it easier to match the useful life of technology (which may be as short as two to three years) to the terms of a lease, rather than locking it into longer depreciation cycles which make it difficult to replace obsolete technology. New technology often improves business performance or improves the price/performance curve, so businesses cannot wait for a depreciation cycle to be completed and remain competitive. Leasing also permits extending the term of the lease should longer usage be required, via a renewal or purchase option, often on very attractive terms.

**Flexible Payments:**

Lease payments are designed to fit the lessee’s cash flow or other financial requirements. Usually, lease payments are simply the total value of the lease divided by its term. However, lessees can arrange to pay less in early stages of the lease and more when revenue from the project is anticipated, or to delay payments entirely until the revenue generating stage occurs; they can also match anticipated seasonal revenue flows (as in the retail toy business when much of the year’s money flows into the firm in the months just before Christmas).

**Decreased Risk:**
Leasing can offer decreased risk.

- The lessee can reduce the risk of the residual value of their acquisition being less than they anticipated by tying in a value at the beginning of the lease.

- Large Lessors like IBM Global Financing can spread their risk over a larger portfolio with a diverse assortment of clients and assets; this allows them to offer leasing at lower rates and access to a larger variety of available assets.

- Lessors can offer an orderly disposal process so that the lessee does not have to consider the variable and sometimes unpredictable costs of disposing of equipment at the end of a lease. The lessor will be in charge of collecting, refurbishing and reselling, or disposing of used equipment, using procedures that are in compliance with any applicable environmental laws. This can be included in the initial lease rather than having to be negotiated and paid for at the end of the lease period.

**End of Life Planning:**

Leasing allows for planning how to end one technology cycle and bridge to the next. This does not always occur neatly at the planned end of the lease. Rather, changing business needs or changes in available technology may make it attractive or necessary to stretch out the lease for some equipment or switch to new technology sooner. A good lease allows for these possibilities. It also provides, as noted above, for the orderly removal of equipment and data and, if needed, environmentally responsible disposal of products included in the lease.

**IBM GLOBAL FINANCING IS THE BEST LESSOR**

As in any long-term business arrangement, selecting a partner can be as least as important as selecting the product itself. This means selecting the right partner should take precedence to finding the least expensive lease. The right partner offers far more than financing at an attractive price.

First and foremost, IBM can provide capital for the lease (in many cases) at a cost below the customer’s borrowing cost. Then IBM will manage the administration of the lease more efficiently. IBM can build an appropriate residual value into the lease as well as understanding how to remarket the intended purchase at the end of the lease. These can be accounted for in drawing up the lease terms and result in a more favorable price for the lessee.

IBM can offer the customer a better TCO (Total Cost of Ownership) on the hardware acquisition and throughout the IT lifecycle with a pay for use approach (at competitive rates) and by refreshing the technology more frequently. For example an FMV lease in terms of present value savings can be as high as 16% over outright purchase (depending on the equipment, term, client credit among other factors). That lower cost would be incorporated into the TCO calculation, making the TCO lower. Other advantages of leasing, such as the ability to upgrade sooner (thereby lowering operating / maintenance costs seen with older equipment), or the better administration tools IBM offers the customer can also be calculated into the TCO.
Your lease partner must have the expertise to understand the solution to be financed over the entire term of its lease. This means not only being able to understand and finance the entire solution, but being able to finance it all: hardware, software and services, from design through implementation. It also means understanding multiple vendors’ offerings and being able to support them in the lease, across any geography, and for a variety of lease periods.

IBM Global Financing has the ability to be very flexible during the term of the lease. This can be built into the lease terms or dealt with as financial or other customer needs change during the course of the lease. For example, if newer (and more suitable) upgradeable technology comes into the marketplace, IBM Global Financing can arrange to swap out new for old and rewrite the lease appropriately; there’s no need to lose the competitive advantage of new technology.

With its vast experience with all types of IT situations and its expertise across nearly any technology need a customer might require, IBM Global Financing is prepared to both write the lease that is best suited to the customer’s needs and to manage the lease with full knowledge of how the customer’s changing requirements may demand changes in their computer assets.

Customers need leases that offer ease of administration, taking into account that the customer may be managing a number of lease arrangements with different terms and lease periods; this is particularly an issue for larger customers with many and complex leases to oversee. IBM is experienced in helping to manage these complex situations and can, for instance, offer a web portal as a convenient way to provide both detailed information and easy access.

Other advantages of working with IBM Global Financing include:

**Contract and administrative flexibility** - This means contract terms, such as payments, can be customized to the lessee’s needs. Payments can be structured to be monthly or quarterly, level or stepped to match anticipated revenues. At the end of a lease, every item can be handled individually (its lease renewed, purchased by the customer, or returned to the lessor). IBM Global Financing can provide $1 buyout options for FMV leases or offer other options such as special financing to meet a continuing need. They include asset insurance in its leases, so the customer has one less part of the process to consider. Lease portfolios can be managed on-line with the IBM Global Financing Customer Center Lease Management Tool, throughout the term of the lease, with 24/7 service available through web access. This tool offers access to every leased asset and to the underlying terms of each lease agreement. It also can permit the lessee to originate equipment schedules, generate installation acceptances, and finalize end-of-lease options.

**Portfolio expertise** - with both IBM and other vendors’ equipment. This gives it unique remarketing abilities which can result in benefiting the lessee through recapturing the highest possible value at lease end and offering the lowest possible least rates. This can include offering refurbished equipment to users and IBM business partners looking for a less costly solution. IBM Global Financing is also in a position to offer hybrid systems (a mix of new upgrades on remarkeeted assets), field upgrades, and spare parts.
**A wide range of options** – IBM Global Financing offers a variety of options across the broadest possible range of IBM and non-IBM hardware, software, and services offerings. These include predetermined upgrade/expansion fees, short-term capacity increases, mid-lease flexibility, and special low rate financing, where applicable. These special offerings have included deferred payment options and zero-rate financing. A variety of tailored support and asset disposal services can also be included in the lease.

**Global reach** – IBM Global Financing offers its services worldwide with services in more than 55 countries and multiple leases to serve the needs of international and multinational customers. This includes a master lease (International Lease and Finance Agreement or ILFA) for larger multinational customers that require a single set of terms and conditions, covering the conditions found in the Term Lease Master Agreement (TLMA). They offer solutions in Europe, Asia/Pacific, and North America to support the central management of customers’ global portfolios. This can be offered on a country, regional, or global basis, to suit the customer’s preferences.

**CASE STUDIES**

Often, the best way to understand how a vendor like IBM Global Financing offers a service is to look at some real world examples.

**LEGO** is a world-famous toy manufacturer, headquartered in Denmark. Its best-known product is a line of colorful, interlocking blocks, used to build all kinds of objects, together with their accessories – motors, figures, trees.

Its problem is dealing with massive annual growth which created scalability challenges, from employee management to product design and development. LEGO needed to drastically simplify and standardize its IT landscape. LEGO needed to introduce SAP applications based on IBM technology to create standardized yet fully flexible business systems. It achieved a smarter computing solution by using highly scalable IBM technology.

This enabled LEGO to capture business benefits estimated at $150 million on technology investments of approximately $45 million. In this process, LEGO simplified and streamlined its applications and infrastructure. The transformation enabled a more agile business strategy, contributing to a 22% growth in business.

LEGO achieved this with a private cloud based solution that is designed for big data and tuned to the task. This allows them to optimize their infrastructure, optimize their service delivery, and drive innovation. This allowed:

- Managing data from multiple channels around the world.
- Enabling consolidation and analysis of sales data to permit LEGO to uncover new insights
- Improving production planning and forecasting to grow traditional toy sales in a multimedia world.
All of this needed to occur in an environment where the right infrastructure was in place to secure their business data and optimize resource allocation; ensure high availability and reliable disaster recovery; meet international regulatory standards and control business risk; and take advantage of a cloud-based infrastructure including virtualization and rapid development of new products and markets.

To achieve its goals, LEGO replaced its Hewlett-Packard infrastructure with an integrated IBM infrastructure built on IBM Power Systems servers, IBM System Storage technology, IBM System x servers and a suite of IBM Tivoli software, all maintained by Global Technology Services. LEGO bought this infrastructure with the assistance of IBM Global Financing. The capital outlay was deferred by using the equipment itself to provide collateral, and the purchase was made easy with simple budget planning for regular payments. The client reports that working with IBM Global Financing to secure the solution reduced strain on its capital budgets at a time of high growth.

**Packet One** - Packet One is Malaysia’s leading 4G WiMAX telecommunications company with the country’s widest 4G WiMAX network. With well over 200,000 subscribers, P1 is growing at an astronomical rate and is on track to cover more than 45% of the Malaysian population by the end of 2010—only two years after first deploying services.

However, to meet their aggressive business challenge and customer expectations, P1 needed to maximize billable traffic and improve bandwidth optimization over its 4G WiMAX network. Additionally, P1 needed to improve the agility of its infrastructure and increase platform stability, driving improved customer service and business efficiency.

P1 needed a solution capable of handling five times its current transaction volume to ensure speedier response time for its database and application servers, required automated tape backup and restore capabilities for rapid recovery and business continuity and needed a storage solution that could complement its steady growth over the next five years.

In 2008, P1 began its relationship with IBM Global Financing, securing leasing for four data centers across Kuala Lumpur, and had confidence in IBM Global Financing, who was able to offer a leasing package for IBM and non-IBM hardware and services.

Being able to finance both IBM and non-IBM equipment as part of the umbrella agreement with IBM Global Financing is beneficial for P1. It means the company can have a single agreement—one procedure to follow and one set of contracts for all of its IT leasing needs.

With the company’s IT team no longer worrying about the budget, they began working closely with IBM Global Technology Services and third-party vendor, Juniper, to ensure that the new IBM solution integrated with the company’s existing IT environment, P1 implemented a solution based on IBM System Storage XIV as well as:

- Connecting 21 servers to the new storage area network (SAN) environment
- Implementing snapshots for the company’s Oracle, Microsoft SQL and MySQL databases
• Installing and commissioning a new Samba network attached storage gateway

• Connecting the Samba gateway to the SAN and local area network.

The leasing solution from IBM Global Financing enhanced P1’s expansion plan while conserving cash and supporting its mission-critical IT solutions. And P1 was able to lower its total cost of ownership (TCO) more than 60% compared with competitor’s solutions. Ultimately, by working closely with IBM Global Financing, P1 was able to craft leasing alternatives to continue to succeed in delivering the 4G WiMAX across Malaysia.

CONCLUSIONS

Against a background of changing economic conditions, leasing can offer an organization the flexibility to preserve its capital assets or the ability to use those assets for other business purposes.

Leasing provides the flexibility to make choices based on the business and IT needs of the customer rather than immediate cash resources and budget constraints.

IBM is the best leasing partner for leasing IT solutions. It is knowledgeable in both technology and industries so it can help the customer put together the best lease solution. It can use its superior position in the financial markets to provide leasing at the lowest possible costs. It can help structure and manage leases that will best suit the customer’s needs, ranging from how payments are designed to residual value, to end of lease life planning.

For additional information on IBM leases from IBM Global Finance, please visit: http://www-03.ibm.com/financing/us/lifecycle/plan/leasevpur.html

Wohl Associates is a consulting firm that specializes in the commercialization of new and emerging technologies. Today, the firm’s interests are targeted on enterprise software, SOA, Cloud Computing, and new business models. Amy Wohl is the principal consultant of Wohl Associates and is a well-known speaker, writer, consultant, and commentator on the information industry.