Setting the Record Straight: Why Lease Finance is Preferred over Cash

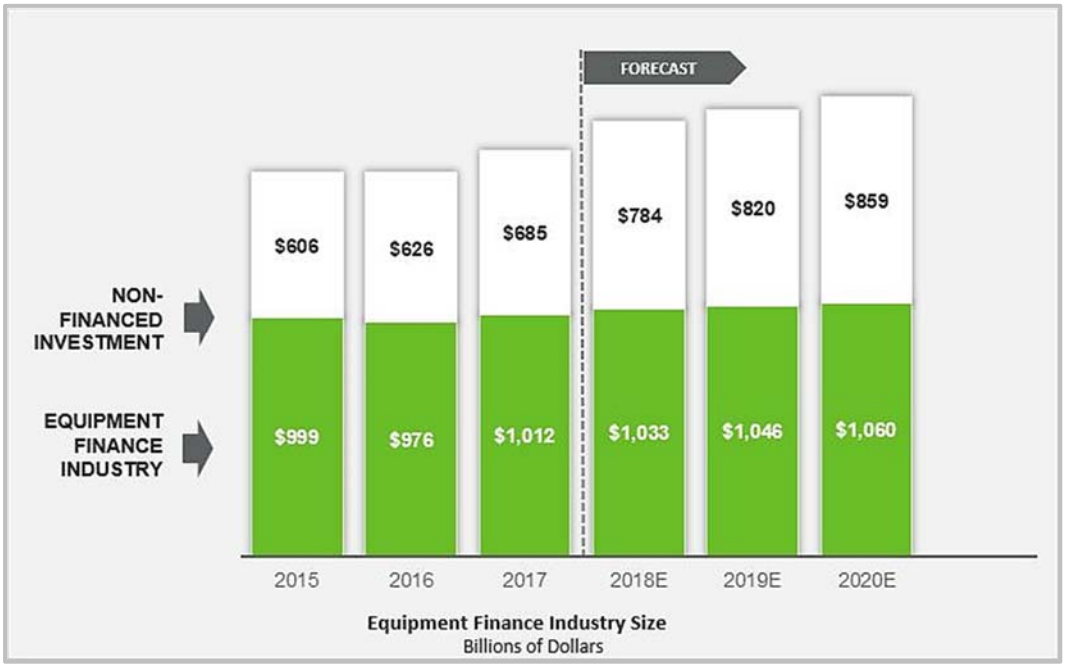
INTRODUCTION

Occasionally one hears in the marketplace that leasing is slow, labor intensive, burdensome, or inflexible. These types of criticisms are not voiced by people who actually use leasing, but are somehow believed by others who either haven't leased anything with an enterprise-grade lessor within the last decade, or who don't otherwise have an accurate knowledge of modern leasing practices, operations, and accounting, or how leasing fits into the complex regulatory environment of today.

The view that 'cash is king' for equipment acquisition—because it is just simpler—is just no longer true. Cash may still be king for strategic investments, but gone are the days when the use of cash was seen as easier, faster, better, more fiscally savvy than financing and/or leasing. The market has left that perspective behind—as evidenced in the realities of equipment acquisition today.

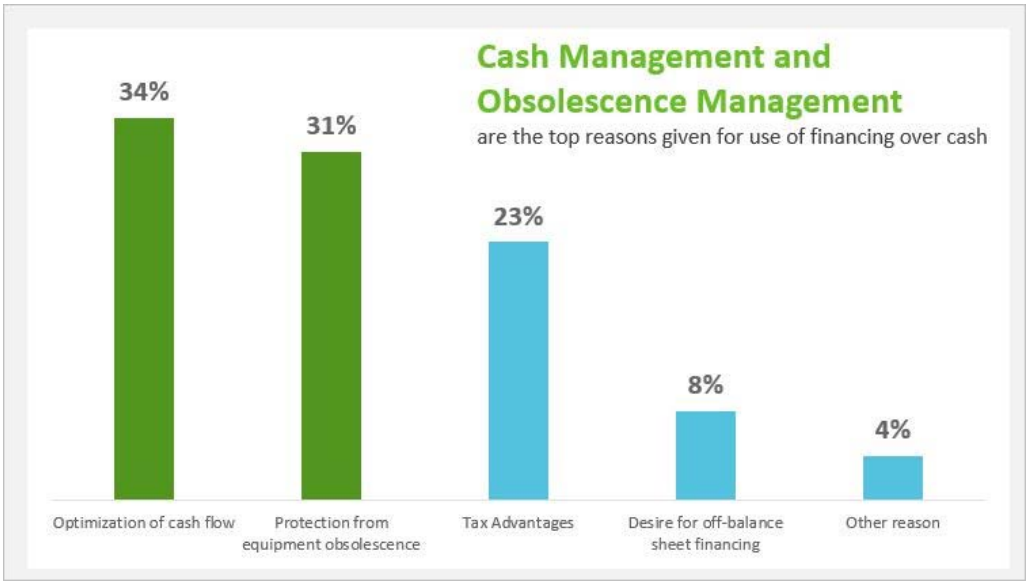
REALITY – FINANCING IS PREFERRED OVER CASH FOR EQUIPMENT ACQUISITION

We have an abundance of data showing that the majority of capital equipment in the US is financed—and has been so for several years:



Survey of Equipment Finance Activity 2019, ELFA

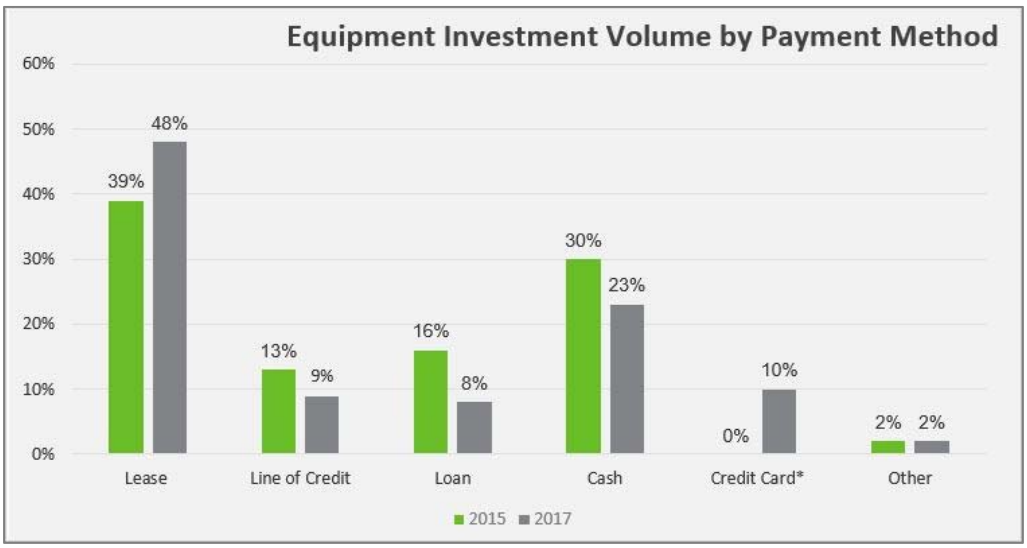
And the reasons given in that data for preferring financing over cash make perfect sense in the competitive marketplaces of today:



Top Reasons Given for Preferring Financing over Cash

REALITY – LEASING IS PREFERRED OVER CASH FOR EQUIPMENT ACQUISITION

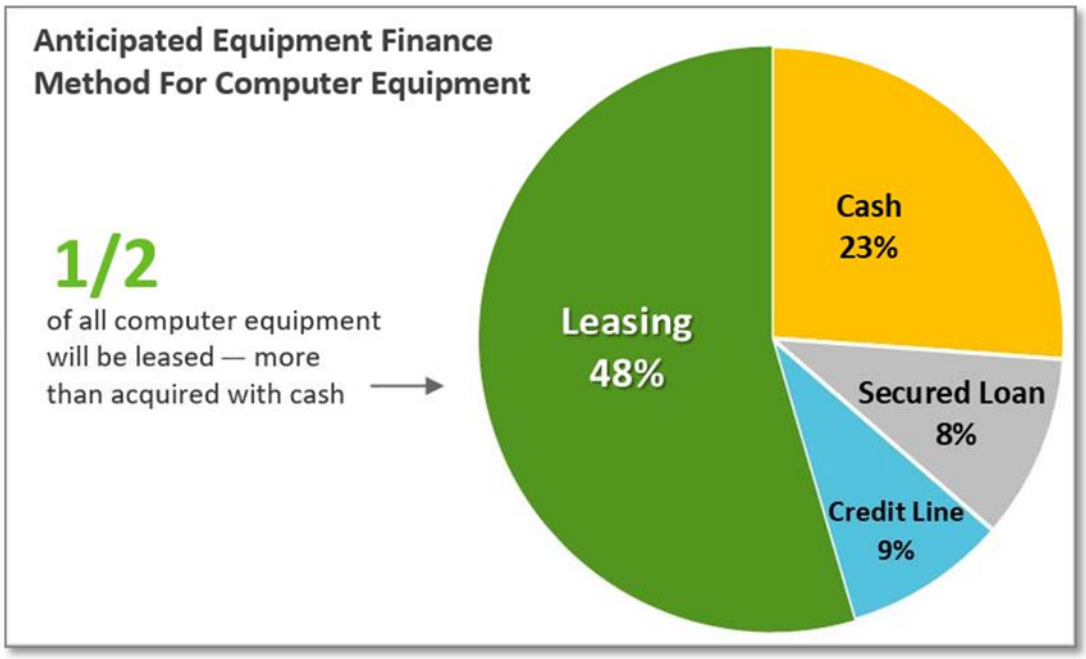
After 2012, a change in financing preferences occurred in the US, with lease finance becoming the tool of choice. As a financing tool for all equipment types, it is now used for asset acquisition **more than cash and secured loans combined**:



ELFF 2018 Equipment Leasing & Finance Industry Horizon Report; Keybridge LLC

REALITY – LEASING IS PREFERRED OVER CASH FOR COMPUTER EQUIPMENT ACQUISITION

And for **computer equipment**, the same is true:



Source: Foundation end-user surveys, 2018

If there was really something 'wrong' with leasing, these high numbers simply could not exist. The value of leasing—when looked at carefully—for equipment, and especially computer technologies—is widely recognized. The Market has voted with its dollars: LEASING is easier and more cost-effective than any other alternatives – including CASH. Businesses in the US obviously don't see it as too cumbersome, too slow, bothersome, or inefficient!

Let's set the record straight by examining how this can be the case.

LEASING IS FASTER THAN CASH

Leasing is often much faster than large CAPEX approvals. Technology leases are generally operating expenses ("operating lease treatment" in FASB), as opposed to capital budget (CAPEX) items. As such, they do not generally require the formal capital budgeting process approval—which can take months, and which might even force alignment with fiscal year boundaries! Decisions for a technology refresh and the subsequent implementation can be initiated much faster with leasing. Since the technology architecture review/approval (by IT) must occur in both CAPEX and OPEX situations, the difference in speed is solely a function of financing source and approvals. And leasing can often be the fastest way to get business solutions into play.

Leasing is almost always faster for dealing with budget overruns. It is a common scenario in large IT projects, that more equipment is needed than was budgeted for and approved by CAPEX processes. Rarely would an IT executive be able to go back to the budget committee with an 'oops—we need another $X million dollars' and get it right then! Leasing is the only real way to get 'emergency' funding for urgent, unexpected, critical need.

Leasing is almost always faster for dealing with end-of-life tasks. An enterprise-grade lessor will partner with an enterprise-grade ITAD (IT Asset Disposition) company. Leases are built in such a way as to fund the ITAD partner to show up on site, do certifiable and auditable data erasure processes, and re-package and return the asset to the lessor. This eliminates those steps from the client workload (often at a higher level of quality, due to specialization)—making the process faster from a client standpoint.

Leasing is almost always faster for getting a solution into service. Whether CAPEX approvals are required or not, it is almost always faster to get approvals for something that costs less (invoice-wise) and something that burns cash slower. Phrases like 'no money down', 'zero-interest finance' and 'low monthly payments' (which apply to IT equipment leases) mean something in the commercial world, just like they do in the consumer world!

LEASING IS EASIER THAN CASH

Leasing is often much easier on Accounts Payable (A/P) processes. A large scale endpoint refresh, which might include equipment from multiple vendors and service firms, would typically generate scores (if not hundreds) of invoices to be entered/monitored/released in the A/P process and system. With an enterprise-grade lessor there are generally contract structures ("lease lines") than only generate one (or a small number of) invoices per quarter. The lessor has the responsibility to pay the mass of invoices, which reduces workload and speed throughput of AP personnel and processes.

Leasing is always much easier on ITAM functions. A lot of our clients--early in the implementation planning phase--realize that our side of the asset management function will actually eliminate several ITAM tasks on their side. For example, in a multi-vendor world, many of the functions of ITAM processes are things the lessor has to do as a matter of course, such as vendor invoice reconciliation, serial number entry into a centralized asset database, assignment to cost centers, timeline for action steps, recording of model and features and so on. These are onerous and error-prone processes, but for the lessor it is their lifeblood. This high-level of process quality often reduces the client side workload of the ITAM process substantially.

Leasing is often easier on IT workload. When deployment and disposal services are bundled into an equipment lease, IT can enjoy the workload reduction associated with outsourcing those task, while paying for those services over time. Those services could be paid with Cash, but that would create spikes in the budget, whereas leasing straight-lines it.

LEASING IS LESS EXPENSIVE THAN CASH

Leasing is less expensive than an up-front cash purchase. IT equipment leases are based on residual-value economics, and the lease payments never total up to the cash purchase price on the equipment invoices. In fact, in the case of FASB-defined operating leases, the total all-in payments have to be less than 90% of the equipment value to even be classified as an operating lease. That means that leasing always involves less cash outlay than purchasing. So the organization can get the same amount of assets for less money, or get more assets for the same amount of money. The organization just gets more productive assets for its investment dollars.

Leasing is less expensive than cash for out-of-cycle unit refreshes. Lease finance is the most economical way to accommodate unplanned and out-of-cycle refreshes. These play havoc with the mandated depreciation cycles of purchasing and cash flow. For example, for 2,000 endpoints, a 3-year refresh, a 10% mid-cycle refresh, and an $800 unit cost, the book value write-down and extra interest cost of accelerated cash outflow is around $30K per year—an equivalent of 37 extra systems per year.

Leasing is less expensive than cash for financial position. The financial executive knows that cash is not 'free'—there is always a cost-of-capital that must be recognized in all funding actions. Cost-of-capital can be visualized as 'interest' on a loan, even though it is not accounted for as such. Operating leases are not only interest-free (compared to a loan) but the financial calculation of 'implicit borrowing rate' always yields a NEGATIVE number for IBR, as compared

with CASH or DEBT. It is less expensive than all other funding methods because the lessee is not paying for the whole thing. Residual value economics reduce the cost-to-client to less than 100% of the solution cost, creating a 'savings gap' between it and any other financing which is based on 100% of the solution cost.

LEASING IS MORE FLEXIBLE THAN CASH

Leasing is more flexible than cash for technology changes. When the business needs to change a technology footprint out—before it is fully depreciated—they are either 'stuck with it' or they have to 'eat the whole thing' accounting-wise. The cash spent on purchases cannot be 'called back', especially since it was paid up front. With a lease structure, leases can be rolled up to new assets for much less expense/accounting cost. This is a powerful tool for staying nimble and being able to leverage best-of-breed technologies.

Leasing is more flexible than cash for continuous upgrades. In the case of distributed assets, refreshes today are known to be continuous. Gone are the days when tech refreshes were 'spiky' and sporadic, and when cash (as CAPEX) could be fought-for and allocated on that same sporadic basis. Nowadays, the expense of refresh is continuous and operating expense structures are much easier to create, modify, and expand to accommodate constant change.

Leasing is more flexible than cash for customizing cash flow timings. Some industries and some organizations have special needs to match cash outflows with cash inflows. Highly seasonal organizations, for example, may need to get productive assets into play early, while paying for them on an irregular and non-standard period structure. Experienced lessors with deep pockets can match payment streams to the customer's specific situation.

LEASING IS MORE MANAGEMENT-FRIENDLY THAN CASH

Leasing is more management-friendly than cash for technology changes. Leasing forces a discipline on the users of technology that cash doesn't. A lease structure forces the organization to assess—as it approaches the end of a lease period—to ask itself the questions of economic value of the asset to the business. Is there a business justification to keep the asset in place? Should we replace it with a newer model—are we going to use the new technology for business gain? Can this business unit 'sign up' for the cost of the asset on the conviction that it will provide the business utility it needs? These questions—and others—should be asked for every asset at the end of its warranty/best-lifespan period. But under a purchase scenario, that generally doesn't happen—there are too many other 'economically-charged' items that come first. By making asset ownership/usage INTO an 'economically-charged' item, finance, IT, and the business units are forced to ask the questions they should be asking anyway. The 'pay for it and forget it' is not an 'advantage' of Cash purchase (as commonly thought)—it is a major disadvantage, bordering on the fiscally irresponsible, and flying in the face of asset management best-practices.

Leasing is more management-friendly than cash for asset management. Leasing 'sits on top of' a sound asset management process. It both presupposes one, supports one, and—often—justifies one on the basis of savings. When such an under-structure does NOT exist, the enterprise lessor can suggest one (from its experience in hundreds of other large accounts) and help build/implement one (from its history of doing so in many same-situation accounts). Companies might not be good at asset management before they start leasing, but all of them will be much improved after leasing processes are implemented. Leasing—with an enterprise-grade lessor—can introduce best-practices and/or improve existing processes, all without the time and money cost associated with hiring consultants to re-engineer those processes. That makes leasing both faster and less expensive than consulting services for implementing change in this specific area of ITAM.

Leasing is more management-friendly than cash for accounting and accountability. Leasing adds another level of detailed reporting and audit-trail (all at the lessor's expense—not the lessee's) useful in all compliance and regulatory arenas. Everything from market-value validation (e.g. FMV determination at end-of-lease) to data erasure certification, from privacy-friendly secure disposition to social/environmental reporting is part of a modern lease arrangement,

made with enterprise-grade leasing partners. Leasing supports better cost accounting for projects (especially billable) because the cost/project center can be assigned at lease inception and at lease changes.

Leasing is more management-friendly than cash for IT service management. IT service management (ITSM) often depends heavily upon a comprehensive and accurate inventory of the assets it supports. This is typically done in a CMDB (configuration management database) in ITIL or ITIL-like frameworks. If the data in the CMDB is faulty, the IT service cost is correspondingly higher. With a multi-vendor leasing partner, through which the vast majority of assets flow, the CMDB can be populated up-front for every new asset entering the footprint. This can save time, money, and user frustration. Without this "for-free" quality data feed, IT (or somebody) has to bear the cost and responsibility of entering, integrating, managing, certifying, and monitoring this incoming asset data. With leasing, it is pre-built and of highest-quality, reducing cost in time and money.

PUSHBACK: "IT MIGHT MAKE GOOD FINANCIAL SENSE, BUT IT ADDS TOO MANY ADDITIONAL STEPS"

It is easy to see why people would believe this, since leasing obviously adds steps to the lifecycle process, but what is often not considered is the fact that it removes steps and/or shortens process times as well. Any steps that it adds are essentially good business practices of accountability, recording/audit trails, and asset management. These tasks should be implemented anyway—regardless of the usage of lease finance.

To show the impact of lease finance on the tasks/steps of the IT asset lifecycle, you start with three basic questions:

1. How does leasing affect this task/step?
2. What additional tasks are required under a leasing program?
3. What tasks are eliminated or reduced under a leasing program?

When you ask these questions of each step—for a typical scenario—at the detailed level, you net out at this general summary assessment (see Appendix for detail):

Phase	Time Impact
Plan	Neutral, +/- 2 weeks (depending on complexity)
Acquire	Some Time Savings
Deploy	Definite Time Savings; More if service bundles are used
Operate	Some Time Savings
Support	Neutral
Move	Neutral
Upgrade	Neutral (or same as basic lifecycle)
Direct	Possible Minor Time Savings
Retire	Neutral or Minor; More if ITAD service bundles are used

Of course there could be wide variations in experience, but few enterprises 'complain' that implementing leasing is too consumptive. In fact, organizations that leverage leasing often report significant improvements in efficiency and in the factors we examined above.

Let's look at some of those reports – to see what really happens in a lease-adoption scenario.

WHAT HAS THE MARKET ACTUALLY SAID ABOUT THE LEASING EXPERIENCE

A sampling of surveys of actual users of lease finance for technology assets (e.g. IT and medical devices) illustrate how lease processes are experienced. Here are 4 such surveys from the 2006-2014 time frame, in chronological order.

Global Insight, 2006.

According to a survey by Global Insight, the top five reasons given for leasing PCs were these:

Top 4 reasons for leasing PCs	Cited by
Discipline imposed on maintenance and replacement	65%
Protection against obsolescence	54%
Off-balance sheet accounting	53%
Convenience	51%

*Based on Global Insight survey findings reported in *(Don't) Look Deep into My Lease*, CFO Magazine 7/1/06

Although we might expect the top two reasons—as reflective of sound management and risk mitigation—some would be surprised that "Convenience" was in the top 4. This would not have been the case if leasing were truly 'inconvenient'!

IDC, 2010.

From the IDC report:

> "In a recent research project conducted during April 2010, IDC surveyed 208 companies about their experiences, their degree of satisfaction, and related business outcomes when using leasing and financing to acquire and manage their IT resources. The survey included companies ranging from 100 to more than 2,500 employees that are based in North America representing 12 different industries."
> *(IT Leasing and Financing: Strategic, Operational, and Financial Factors to Consider", IDC)*

The benefits were reported in categories of Operational and Financial. Since the 'too slow' objection is about operational speed, we will only give those 5 factors here (in rank of importance).

1. **Protection against obsolescence.** This was rated as the most important benefit of IT leasing/financing.
2. **Readiness to Serve**. "This requires an IT organization to rapidly provision, to rapidly respond, and to faultlessly anticipate. For these reasons, an IT leasing and financing program that allows additional orders against a pre-established credit line significantly enhances the ability of the organization to respond while simplifying paperwork…"
3. **Administrative integration**. "… combining monthly payments for maintenance and lease payments has been identified by many IT buyers as a desirable to reduce their administrative requirements."
4. **Fast approval process**. "Over 75% of the organizations surveyed reported that one of the major benefits of using an IT leasing and financing program was the fast approval process."
5. **Proper equipment disposal**. This is the "requirement to properly dispose of surplus equipment, for both ethical and regulatory reasons…"

Notice that items 2, 3 and 4 are about faster process times.

IDC, 2012.

The IDC survey (*IT Buyer Perceptions, Strategies, and Requirements: Results of IDC's 2012 IT Leasing and Financing Survey*, Jennifer Koppy, IDC, June 2012) across all industries in the US listed these benefits as the ones cited most by those who leveraged leasing (emphasis mine):

1. Reducing costs (79%)
2. **Improving operational efficiency** (74%)
3. Flexible upgrade options (72%)
4. Flexible terms and conditions (70%)
5. Ability to lease or finance new equipment types (70%)
6. Managing and reducing risk (63%)
7. Conserving capital (62%)
8. Ability to finance total solutions, including bundled hardware, software, and services (55%)

Notice that item #2 is about process speed and accuracy; and #3, #4, #5 and #8 are about flexibility.

Siemens, 2014.

A 2014 survey of **Global healthcare CFO's** [Siemens report "*Taking the Pulse: How healthcare CFOs around the world are managing change*: (Winter, 2016)] documented CFO perspectives on asset finance, and singled out some of the characteristics that were key to their evaluation:

> "The last point involves examining respondent views on the financing techniques they regard as particularly useful in enabling essential new-generation, digitalized technology investment to meet their main pressures for change. Over half of respondents said that they are already using alternative financing techniques to access funding and appropriate financing arrangements that are sympathetic to their cash-flow requirements – asset finance, consumables-based finance, invoice finance and managed facilities were cited in particular.
>
> "Of all techniques mentioned, various forms of asset finance are evidently the most popular, with **over half of CFO respondents noting that financing techniques such as leasing and renting are important to their ability to manage the major pressures** for change that they face. They particularly value the **ease, adaptability and extensibility of asset finance** plans to fit their individual circumstances."

CONCLUSION

The 'proof is always in the pudding' and these survey results show that – in addition to the financial benefits—leasing improves operational processes, reducing the time-cost of many steps and making the IT enterprise just work better, faster, more efficiently—in its pursuit of service.

We at Huntington Technology Finance see the same values realized by our clients. From a client-side perspective, using HTF's 28-year mature lease documentation has proven to be the easiest according to our customers. We have customers who have used us for 28+ years, and others that have leased over 1,000 lease schedules with us. At this point in time, we have 8,778 lease schedules in place, with 96% client repeat business. This kind of success just cannot happen if leasing is truly 'slow, labor intensive, burdensome, or inflexible"!

We stand ready to work with you and your technology and service providers to leverage this tool to harvest both financial and operational gains.

Learn More.
Contact Huntington Technology Finance at (248) 253-9000 or technology-finance@huntington.com.

Appendix: Impact of Lease Processes on Lifecycle Task Times

Phase	Ref#	Task or focus	How does leasing impact this task?	What additional tasks are required if leasing?	What tasks are eliminated or reduced if leasing?	Time impact
Plan & Prep	1	Demand forecasting				
	2	Design configuration & model selection	Allows bigger unit per $			
	3	Technical review and approval				
	4	Supplier selection, price negotiations				
	5	Rollout timing plan				
	6	Decide financing strategy: Cash/CAPEX or lease finance	Allows consideration of alternatives	Solicit suggestions from lessor		Negligible
	7A	CAPEX proposal construction and defense or;				**CAPEX process (4-10 weeks?)**
	7B	Negotiate Master lease agreement; build-out unit/cost-center Schedules		Vet HTF, negotiate MELA	CAPEX proposal construction and defense; wait-time	**MELA (1-2 wks), build Schedules (1-2 wks)**
	8	Refresh strategy				
	9	End of lifecycle process design		Include HTF/ITAD vendor in meetings		Negligible
						Neutral, or +/- 2 wks
Acquire	1	Orders placed with vendor(s)		Copy to lessor/HTF		Negligible
	2	Receipt of goods (central site)				
	3	Inspection and acceptance		Notice to HTF/lessor instead of vendor		Negligible
	4	Update Order systems/ Accounts Payable/ITAM			Data feed from HTF/lessor eliminates need for re-keying and QC'ing	**Savings in the 1-3 weeks labor cost per year, for large pools of assets**
	5	Pay vendor		Payment to lessor/HTF; HTF pays vendor	Fewer invoices required with HTF/lessor, than with purchase	**Accounts Payable manual process tasks reduced by over 1/3rd**
						Definite Time Savings
Deploy	1	Staging (at central site)	Could be provided by vendor; bundled cost spread over term	One-time set up of Initial lease contract/SLAs	Would remove/reduce these steps	**Considerable savings (could be a month per year in labor, depending on number of assets, for these 3 deploy tasks)**
	2	Asset tagging and admin	(above)	(above)	Would remove/reduce these steps	(above)
	3	Imaging and/or software loading	(above)	(above)	Would remove/reduce these steps	(above)
	4	Configuration for specific install				
	5	Network attachment				
	6	Migration of data from prior unit				
	7	Security/authentication enablement				
	8	Allocation/access rights to shared resources				
	9	Verification and signoff				
	10	Updating of central DB's (e.g. assets, service CMDB)		Input ITAM data to CMDB, other SORs	Data feed from HTF/lessor eliminates need for re-keying and QC'ing	**Savings in the 1-3 weeks labor cost per year, for large pools of assets**
						Definite Time Savings; More w/Bundles
Operate	1	Facilities monitoring (e.g. heat, dust)				
	2	Consumables				
	3	Insurance				
	4	Data protection monitoring				
	5	Security updates				
	6	Backups				
	7	Monitor/adjust usage of shared resources				
	8	IT audit -- software, ownership, asset mgt	Master inventory list easy to determine	Receive master inventory list from HTF/lessor	Reduces labor cost to build master inventory and/or QC it	**Could save several days, and manual methods might not even work**
						Some Time Savings
Support	1	IT support staff training				
	2	End-user training	Could be provided by vendor; bundled cost spread over term	One-time set up of Initial lease contract/SLAs	Would replace these steps	**Considerable (**but not due to leasing per se, but better funded by it**)**
	3	Help-desk / service desk	(above)	One-time set up of Initial lease contract/SLAs	Would replace these steps	(above)
	4	On-site support	(above)	One-time set up of Initial lease contract/SLAs	Would replace these steps	(above)
	5	Hardware maintenance and loaners				
	6	Repairs				
	7	Warranty claims				
	8	Monitoring for improvements and problems				
						Neutral

Appendix: Impact of Lease Processes on Lifecycle Task Times

Phase	Ref#	Task or focus	How does leasing impact this task?	What additional tasks are required if leasing?	What tasks are eliminated or reduced if leasing?	Time impact
Move	1	Pack, secure, transport to new location, redeploy				
	2	Update asset mgt records		Copy to HTF/lessor		Negligible
						Neutral
Upgrade	1	Business justification for pre-refresh upgrade	(Same as above - no change)			
	2	Procurement processes	(above)			
	3	Delivery/reconciliation	(above)			
	4	Install/configure/verify	(above)			
	5	update all DBs of record	(above)			
	6	Cost assignment	(above)			
						N/A
Direct	1	Review business utility of unit				
	2	Solicit feedback from user on direction				
	3	Assess economic value/alternatives		Receive financial data from HTF/lessor	Reduces data gathering and value determination tasks/costs	**Some labor savings in research, if assets are not completely uniform**
	4	Decide on RETIRE/RETURN, EXTEND, PURCHASE, or WAIT		Notify HTF/lessor		Negligible
	5	If EXTEND or PURCHASE		One time modification to Accounts Payable		Negligible
						Possible Minor Time Savings
Retire	1	Schedule ITAD		Notify HTF-lessor/ITAD		Negligible
	2	data migration				
	3	software harvest				
	4	data erasure (ITAD)	Could be provided by ITAD vendor; bundled cost spread over term)	One-time set up of Initial lease contract/SLAs	Would replace these steps	**Considerable (could be a month per year in labor savings, depending on number of assets, for these 3 retire/return tasks)**
	5	data erasure documentation	Could be provided by ITAD vendor; bundled cost spread over term)	One-time set up of Initial lease contract/SLAs	Would replace these steps	(above)
	6	restore to required condition				**Neutral--would be required for resale also, to recover residual economic value**
	7	pack/removal/transportation	Could be provided by ITAD vendor; bundled cost spread over term)	One-time set up of Initial lease contract/SLAs	Would replace these steps	(above)
	8	update all DB's of record		Receive final documents from HTF/lessor		**Some time savings from automated reports**
						Neutral or Minor; More w/ITAD bundled