Are Flexible Financing and Consumption Models Replacing CapEx for ICT Procurement?

Asia Pacific Organizations Share Their IT Procurement Strategies.

ICT Financing Insights
April 2016

External Factors Affecting ICT Purchasing Decisions

Strong US dollar

Growing strategic relevance of IT in business

New lease accounting rules

> "We use the leasing model as it removes upfront capital investment, and turning the investment into a recurring cost makes our accounting people happier."
>
> **CIO, Australian government organization**

The procurement of information and communications technology (ICT) has changed radically in recent years because of the increasing popularity of cloud and other consumption-based services.

We wanted to understand more about these changes. So we asked market research company International Data Corporation (IDC) to interview 15 senior IT decision makers from public and private sector organizations in Australia, India, Malaysia, and Singapore.

ICT purchasing is changing in the Asia Pacific Region

The research shows that the cloud has helped businesses move away from the highly restrictive, conventional model of large capital expenditure (CapEx) cycles every three to five years. Today, companies can choose from a wide range of ICT products and services as well as financing and purchasing options.

The growing influence of mobility, cloud, social media, and big data has produced a fundamental change in technology platforms. It has also altered how organizations and individuals adopt and adapt to this technology-centric way of life.

Despite some predictions, onsite ICT systems show no sign of disappearing. What *has* changed is how many organizations want to buy them.

Across developed and developing markets the landscape is changing, largely because of more flexible, external financing options. Companies in the less-developed markets want to decrease their direct purchases in favor of other options, such as utilizing cloud services and consumption models. Companies in the more-developed markets, are using more financing to increase direct ICT purchases for certain classes of equipment.

In a previous Cisco Capital industry insights paper[1], we noted, "this appetite for financing is being driven by the proliferation of end-user devices, and the rapidly growing adoption of unified communications, and video- and web-conferencing technologies."

Just how popular are the various financing options, and why? What can your organization learn from the purchasing trends?

Key Expenditure Trends

One thing that's clear from the IDC research is that ICT investment remains a high priority for most organizations. Only one company executive expected a decrease in ICT spending, while 10 respondents said that their budgets were increasing.

For example, the head of IT at an Indian oil and gas company admitted that external factors, such as the strengthening US dollar, were affecting business. Despite this, the company's ICT budget increased 20 percent over the previous year. "Our managing director understands the importance of ICT," the executive said. "Even an organization-wide cost-cutting initiative had no impact on the ICT budget."

Another external factor is the proposed international alignment of lease accounting rules, which could affect companies' assets and liabilities. The International

[1] *New Needs, New Models: How growth and innovation are changing the way Asia Pacific organizations acquire technology.*

Accounting Standards Board and Financial Accounting Standards Board have proposed that leases longer than 12 months for any product or service be reported on a company's balance sheet. This may affect some companies' gearing ratios and debt covenants.

The majority of executives, however, reported that external factors such as currency fluctuations had little or no impact on their ICT purchasing plans.

"Most vendors are willing to drop prices in today's competitive market," said the IT director of a Malaysian educational institution. "It is still going to be slightly more expensive for us–like 10 percent more expensive–but definitely not the 30 percent due to currency fluctuations. We are not greatly impacted by the 10 percent net increase and we will manage the other cost factors."

Among the 10 organizations that are increasing their ICT budgets, the reasons for doing so vary significantly.

Most budget increases are due to special projects. As the head of IT at an Australian government organization said: "CapEx in the next 12 months will certainly increase, but that's a very special circumstance as we have a lot of software that needs to be replaced."

Other special projects requiring additional budget include maintaining and modernizing old systems, centralizing IT services, and deploying a document workflow system.

Financing Data Center Infrastructure

The IDC research shows clear trends in how organizations are purchasing ICT. In particular, it illustrates their willingness to use external financing for their entire ICT solution.

All but one of the surveyed organizations are either partially or fully financing their data center infrastructure. "We use the leasing model as it removes up-front capital investment, and turning the investment into a recurring cost makes our accounting people happier," said the CIO of the Australian government agency.

"Leasing allows us to do more with the same budget," added the CIO of a Malaysian oil and gas company.

Three of the organizations also outsource data center management to enable their ICT staff to focus on other duties.

Hybrids Ease Move to Cloud

The IDC research provides insights into the popularity of hybrid cloud.

According to the IT manager of an Australian educational institution, "For us, the trend is away from the private cloud toward the public cloud. All emails, our messaging tools, and authentication will move to the public cloud. It is just a matter of how quickly we'll move to the public cloud. We will keep our private cloud for backup service so it'll be a hybrid model for us."

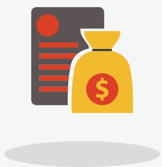
Despite the ongoing shift of non-core workloads to the public cloud, private clouds remain a high priority. All 15 of the surveyed entities have onsite data centers, with seven of them financing their entire infrastructure externally. Their reasons for having them include:

- **Compliance**. "We choose to own our data centers due to banking regulations and data restrictions," said the head of IT at an Australian bank. "Less than 1 percent of the bank's workloads are on the public cloud and almost all reside across the bank's data centers around the world."

Top Three Reasons for ICT Financing

1. To benefit from regular technology refreshes

2. To pursue an asset-light strategy



3. To limit internal upfront capital investment

"We avoid upfront purchases for two reasons. One is technology change. The second reason is fast time to market."

Australian services company

- **Security, backup, and data recovery**. "Our company has recently shifted entirely from off-premise to on-premise for data security reasons," said the CIO of the Malaysian oil and gas company.
- **Custom solutions**. "We're building our own software-defined data center," said the head of IT at the Australian educational institution. "We're looking at automation as well. We still have to keep a legacy environment as the software-defined environment doesn't work for everything, so it's going to be a real mixed bag for us."

Cloud Financing Models

Financing a cloud solution plays an important part in ICT purchasing decisions. Companies are becoming increasingly aware of the benefits of finding the right funding model among the many and varied options available.

For example, an Australian healthcare company allocates 80 percent of its ICT budget to cloud spending. This includes a hybrid model for its IP telephony solution. In this model, the data center is purely cloud-based but the IP telephony equipment is rented through a financing company.

"It was presented to us as a monthly combined figure which is made up of the total cloud solution price and the monthly rental fee for the equipment," the company's IT manager said.

Nevertheless, the move to the cloud is done cautiously. The Indian oil and gas company executive said "according to our analysis, cloud is never a cheaper option. Private cloud is preferred mostly because of security issues."

Buying Hardware, Software, and Services

Most of the organizations finance at least some of their hardware, although it can depend on the circumstances. Some only finance hardware with shorter lifecycles or when equipment costs exceed a certain amount (typically where there's a capital investment limit). More strategic reasons for financing are given by those taking an asset-light approach or those who need their technology refreshed regularly.

"We avoid upfront purchases for two reasons," said the head of IT at an Australian-based services company. "One is technology change ... a cloud solution allows us to change when a technology is no longer relevant. The second reason is fast time to market. We open new office locations all the time, and the short lead times do not allow us to set up our own server rooms."

Some organizations are also financing software and services.

"We find we get better pricing for the overall offer when we put hardware and maintenance together in a three- or five-year lease agreement," said the IT director of a Singapore-based transportation services provider.

Organizations are generally more open to financing hardware than software. This is likely to remain the case for large new ICT projects. For example, looking at the new data analytics and Internet-of-Things (IoT) deployments planned by the surveyed organizations:

- Most of the hardware will be financed
- Software will either be bought outright or on a subscription basis
- Services that are bundled with hardware will be financed

"Our big data implementation is going to mainly have an OpEx [operating expenses] model," said the Australian bank's head of IT. "The hardware is going to be all leased, but we are looking to configuring and integrating the software ourselves."

Choosing Financiers

While a solution’s technical merits are important, financing also plays a vital role. As the CIO of an Indian energy company said: “The availability of external financing positively affects our IT projects as we know that cash flow will not be a problem. We do favor vendors that provide us with a total solution.”

The Australian healthcare IT manager stated that about 70 percent of their needs are financed internally and 30 percent externally. “Financing shifts some risks over to the financier and allows us to leverage the health of our balance sheet to make investments that will improve our IT infrastructure layer and help our business to operate more efficiently,” the manager said.

The manager added that equipment was bought outright or through a financier in the past, but the scenario is changing to financed and private cloud-based solutions. “Leasing through vendors gives us better rates and the process is a lot simpler as compared with trying to finance through the banks.”

While most organizations agree on the benefits of financing, opinions vary about the details of the arrangements.

The Australian educational institution’s head of IT put forward the case for master lease agreements. “Renewing an overall leasing agreement with a sole leasing provider for all of our ICT equipment makes things a lot easier for us. We only have to focus on having technology discussions with the vendors. The operational issues relating to setting up the leases have been taken care of for us. It makes our procurement people happy and it makes us happy as well.”

Other organizations prefer having a few options (see ”Which Financing Solution?“ for a summary).

An Indian professional services executive said, “All top vendors have their applications on the cloud at a reasonable price, so companies will move to the cloud eventually. However, we like operating leases with end-term solutions from vendors as well as pay-per-usage models and see them as feasible options.”

The Australian educational institution prefers managed services. “Not owning things and buying services is what we’d rather do,” the institution’s head of IT said. “We feel leasing is the way to go rather than buying outright. For us, the way we want to go is managed services and if that is not available, our next step will be leasing.”

One thing is certain: organizations can now buy or finance a wide range of products and services in a variety of ways even as they become more virtual. More importantly, financing allows service providers to acquire technology that can advance business benefits. And when budgets allow, they can invest in business development rather than in acquiring IT.

WHICH FINANCING SOLUTION?

Why use a single financier?

Visibility and control.

"It is always nicer for us to deal with only one company for better visibility and control."
– Australian government organization

Data security.

"We do not encourage a multi-partner approach as there is a need to share the company's financial data with the partner." – Indian services provider

Technology focus.

"Renewing an overall leasing agreement with one sole leasing provider...makes it easier for us as we only have to focus on having technology discussions with the vendors." – Australian education provider

Why seek multiple financing options?

Stand-alone deals.

"Each leasing arrangement is a stand-alone as it is driven by different programs or platforms."
– Australian banking and financial services provider

No cross-financing.

"We asked if they (the vendor) can also finance other items and they said no, so we can't work with them for other IT equipment." – Australian services provider

Better rates.

"Our finance department prefers the party with the lowest rate for any agreement."
– Indian oil and gas company

WHY USE VENDOR FINANCING?

- **ICT knowledge**. "Vendor financing makes more sense as they understand the technology."
  – Indian oil and gas company
- **Flexibility**. "It has been easy for us to work with vendor financiers as their processes are simple."
  – Singapore-based services provider
- **Better rates**. "Leasing through vendors provides us with better rates."
  – Australian healthcare provider
- **Minimum loan amount**. "A bank loan cannot be given for ICT procurement unless the loan amount is very huge, which is not the case for us."
  – Indian manufacturer

Find out more

To view a related infographic, please click here.

Clearly, different financing solutions suit different organizations and circumstances.
Let Cisco Capital help you with your choices.

To find out more, please visit www.ciscocapital.com/apjc or email ciscocapitalapac@cisco.com