IBM Global Financing
January 2009

Software and Services Financing

Contents

Executive Summary

Software and services form the largest and fastest-growing part of the information technology market. Worldwide in 2009, software and services are expected to account for more than 76% of the total information technology market for commercial and government entities. In 2009, spending on software and services is expected to grow 3.5%, versus a -0.5% decline in spending for information technology hardware.

In 2009, one third of all the worldwide financing originations is expected to be software and services. Together, software and services is expected to account for 39% of the worldwide client information technology financing market.

(Source: IBM Market Insights October 2008 QMV4Q08 IT Spending estimates and September 2008 estimates of Client Financing Propensity)

Software and services financing is growing rapidly fueled by growth in the two underlying business segments. In addition, market dynamics—such as the desire for total solutions and the drive to implement IT infrastructures—are increasing clients' propensity to finance software and services. Integrated solutions and IT transformation lend themselves to financing because they often require considerable up-front spending. In addition, financing helps clients to match payments with the realization of business benefits from their software and services initiatives; conserve cash for use in other parts of the business; and simplify financial management of complex projects.

Software and Services Financing

One of today's greatest information technology challenges isn't technological—it's financial. A major challenge confronting decision makers is making wise choices when it comes to paying for the technical assets essential to business operations.

Highlights

Financing information technology hardware is an accepted way of doing business. Clients are discovering the benefits of financing software and services and, in the process, are making the financing of software and services one of the fastest-growing segments of the information technology financing industry.

Spending on IT applications is growing rapidly. Among those businesses that have already deployed early generation IT applications, the priorities are shifting to infrastructure and better integration. Finally, companies realize that technology is required if their businesses are to survive and prosper.

Market Growth

Software and services are viewed as the keys to gaining business advantage in today's marketplace. As a result, they are already the largest segments of the information technology–related market. Worldwide in 2009, software and services are expected to account for more that 76% of the total information technology market for commercial and government entities.

A number of factors are driving the rapid growth of software and services. The first driver is the demand for consulting, systems integration services, network services, Web hosting, security software, database management and application development tools. A second driver is the shortage in information technology skills, which creates demand for automation and systems management software as well as outsourcing and consulting. Another driver is Enterprise Resource Planning (ERP) and other enterprise-wide software deployments, which are aimed at transforming processes within a business in order to enhance competitiveness, reduce costs and boost productivity. Finally, companies are rapidly expanding their middleware deployments to power their IT architecture.

Factors Driving Clients

In 2009, one third of all the worldwide financing originations is expected to be software and services.

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Software and services are key to business growth. Typical IT solutions have the following mix of revenue: 30% hardware, 30% software, 30% services. To grow a business requires a focus on financing solutions related to two non-traditional areas that do not involve hard assets.

July 2007 – IDC, 2007 IT Leasing and Financing End-User Survey: Customer Needs and Wants

When considering the factors driving clients to finance software and services spending, there are several that emerge, beginning with the trend away from components and toward total solutions:

1. When hardware, software and services are acquired together, they are more likely to be financed than when acquired separately. About half of all software and services financing is part of a bundled solution.

2. The demand for large, mission-critical enterprise solutions—ERP, client relationship management (CRM) and business integration—usually requires large front-end expenditures that can overwhelm information technology budgets.

3. Traditional hardware financing companies are turning to software and services financing. In addition, banks with an appetite for lending are buying information technology financiers—financing companies have decided they must be prepared to finance software and services if they are to remain competitive.

4. More companies are changing their policies to permit financing of software and services.

5. Clients want to conserve cash for other strategic investments.

There are a number of reasons given for financing software and services according to respondents in a study conducted for IBM Global Financing. Respondents said the main reason for financing was that information technology financing results in predictable and easy budgeting.

Generally, financing of software and especially services, focuses on up-front, one-time charges or phased-in charges for multistage projects. Ongoing outsourcing or maintenance charges do not lend themselves to financing (an exception being ongoing charges that are annualized into a single payment).

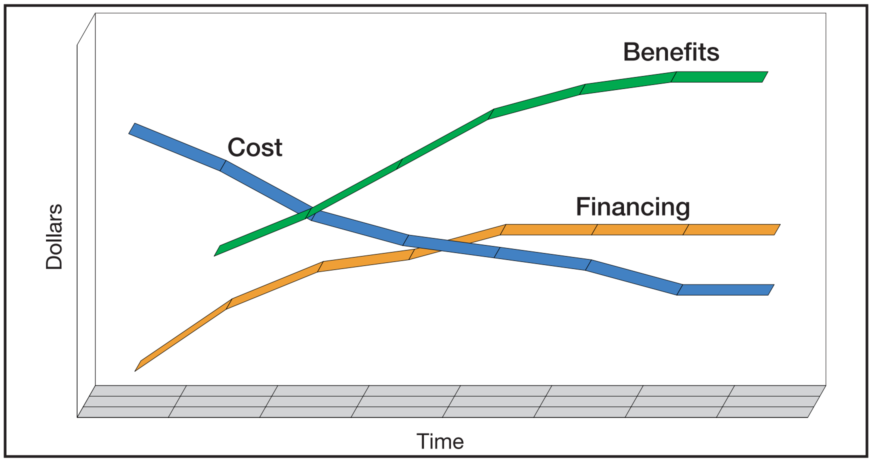
Software and services financing is generally treated as unsecured financing compared to secured financing for hardware products. Rates for software and services financing reflect the unsecured risk. The typical term for software and services financing is three years and down payment and other covenants could be required depending on a client's credit rating.

Several types of companies offer software and services financing. They include: commercial banks (regional and large money-center banks); commercial financing companies; diversified, multi-line financial services companies; and the so-called "captive" financing providers that finance their parent's products.

Highlights

When asked about their main reasons for financing software and services, most companies said that it facilitates the predictability of costs and eases budgeting.

When asked about their main reasons for financing software and services, most companies said that it facilitates the predictability of costs and eases budgeting. There are several additional reasons, beginning with helping companies to match costs with the realization of benefits, which the following chart demonstrates:



Cost-benefit matching is a major reason for financing software and services implementations. As this chart illustrates, costs are heaviest at the front end, while benefits do not fully accrue until the project is implemented. When the project is financed and structured accordingly, costs and benefits track much more closely.

Another major reason for financing software and services is managing the total cost of ownership. An integrated information technology solution will include hardware and software as well as the cost of deploying, managing, servicing and retiring it. Another factor that companies consider is that financing has the ability to accelerate the implementation of large and important projects.

Another facet of this benefit is doing the software or services implementation "the right way"—in other words, not scrimping because of a burdensome one-time payment.

Receiving a single invoice for hardware, software and services financing is an added convenience. Conversely, clients should ensure that, if they are dealing with four or five different suppliers, they don't receive four or five separate financing contracts.

Conclusion

October 2008 – Forrester: Service Providers Start To See The Implications Of The Credit Crunch. Strategists at IT services companies need to focus on the following key priorities:

- *Use financing options for projects as a key differentiator. If a provider offers its services under a financing scheme, client CFOs can further enhance their levels of cost management and control. Medium-size companies with limited cash flow can particularly benefit from such flexible payment measures.*

Businesses seeking to finance software and/or services commitments should consider several factors as they evaluate alternative financing providers.

Knowledge of and commitment to the information technology market are important. The more the financing provider knows about the information technology market, the better able it will be to understand client needs and add value when it comes to terms and structure. The provider should come to the table with innovative ideas that will benefit the borrower. Commitment can be measured by longevity and staying power through all market and economic conditions.

As discussed earlier, an ability to finance the total solution is key. Without it, a client may have to deal with individual financing sources for hardware, software and services and end up with multiple payment schedules and far more complexity than is necessary.

The provider should offer flexible payment terms. Most often, payments are structured on a monthly basis. However, industry or seasonal factors may mean that alternative schedules—e.g., quarterly or semiannual—would benefit the borrower. The financing provider should be open to negotiating payment and other terms to provide the borrower with the greatest possible flexibility.

Software and services form the largest and fastest-growing part of the information technology market. It is critical that companies making large investments in their technologies understand the acquisition options open to them and partner with a financing provider best suited to meet their specific needs.

About IBM Global Financing

As the largest information technology financier in the world, IBM Global Financing offers clients in more than 50 countries leasing and financing solutions for hardware, software and services acquired from IBM and select vendors. In the United States, IBM Global Financing clients are served by IBM Credit LLC.

For more information

To learn more about the software and services financing, please contact your IBM Global Financing representative or IBM Business Partner, or visit the following our Web site at:

ibm.com/financing

IBM Global Financing
North Castle Drive
Armonk, NY 10504-1785 USA

ibm.com/financing

Produced in the United States
January 2009

[1] IDC, Evaluating Technology Life-Cycle Management and Lease-Versus-Own Options, November 2007

GFW03001-USEN-04