

## INSIGHT

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### Lenovo and IBM Global Finance Partner to Deliver PC Leasing and Channel Financing

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#### IDC OPINION

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IBM PCs and laptops are popular within both corporate computing environments and the portfolios of virtually every IT leasing company. As a result, when the sale of IBM's PC Computing Division to Lenovo Group Ltd. was completed on May 1, 2005, justifiable concerns were raised throughout the leasing industry that existing residual value positions, as well as future leasing prospects, may be diminished. IBM Global Financing (IGF), which holds the largest portfolio of this equipment and previously managed the secondary market, announced that as part of the sale finalization, a definitive agreement with Lenovo as the worldwide lessor and remarketing agent of choice for IBM-brand PCs and laptops had also been signed. Recently, IGF provided IDC with a detailed briefing of the program's features. Key findings follow:

- ☒ Lenovo and IGF have entered into an exclusive, five-year worldwide agreement whereby IGF provides end-user leasing for all commercial customers and distribution channels, distribution channel inventory financing, and remarketing services for channel open-box returns.
- ☒ IGF characterizes the Lenovo PC leasing business as a major component of its business plan; IDC estimates that IGF will fund \$1 billion of IBM-brand PCs and laptops annually. IGF has launched several new PC leasing products, as well as expanded operational capabilities for small- and medium-ticket commercial transactions. IGF has retained an independent third-party company to originate small and medium-sized business (SMB) transactions for United States-based organizations, while IGF will continue to operate as the underwriter, portfolio manager, and remarketing agent. IGF advised us that it is currently evaluating other independent companies to provide a similar SMB origination capability for European customers.
- ☒ IDC believes that the residual values for IBM laptops and PCs will continue to generally track with previous experience and industry trends as IGF — the same organization that handled these activities previously and is well acquainted with the risk, opportunities, and pitfalls of PC portfolio management — continues as a major influence in the secondary market.

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#### IN THIS INSIGHT

This IDC Insight considers the five-year financing and remarketing services agreement entered into by Lenovo Group Ltd. and IBM Global Financing and its implications for future resale pricing and trends of IBM-brand PCs and laptops.

## SITUATION OVERVIEW

Despite the perception some have that IT leasing is no longer popular, a number of end-user organizations continue to lease their PCs (and other IT equipment) as an operational practice to better manage technology obsolescence, minimize capital investment in infrastructure assets, and comply with expanding environmental disposal requirements. For these companies, it is not just a question of whether leasing is less expensive at the time of purchase, it is a matter of whether it is less expensive to lease IT equipment through the equipment life cycle. We estimate that approximately 20% of commercially deployed PCs and laptops in the United States are leased or financed. Further, we estimate that 20–25% of Lenovo's U.S. commercial sales are leased or financed, somewhat higher than the average for other brands as the company's roots are strong in the corporate sector.

There is clear evidence that residual values for three- and four-year-old PCs and laptops (from all leading brands) are trending up as many large enterprises extend their portfolio deployments from two to three years to three to four years. Counterintuitively, longer average deployments raise secondary market prices because the volume of available equipment is decreased and additional spare parts are required to maintain aging equipment, the source for which is parts obtained from displaced, dismantled machines.

IBM Global Financing has periodically struggled with the dynamics and requirements of the high-velocity, low-ticket price, operationally intensive PC and laptop leasing market. Over the years, some mistakes were made, some lessons learned, and most business processes tuned. Through it all, IGF has risen to the challenges and matured into a pivotal industry participant — and leased billions of dollars of PCs and laptops.

The decision by IBM and IGF to partner with Lenovo and continue to provide financing and remarketing services is a sound one as many of both companies' largest and most important customers have financed their PCs and laptops with IGF. A radical shift could have been financially and operationally injurious to IGF, its customers, and other third-party lessors holding IBM PC laptop residual value positions.

This program announcement would be interesting if all IGF announced was a continuation of its current offerings in a "steady as it goes" strategy. This is not the case. IGF is investing in new programs, structures, and processes to better serve this business. We believe this bodes well for customers as it means broader and deeper financing program choices from a capable, enterprise-class supplier. Specifically:

- ☒ IGF announced an enhanced, three-tier PC lease pricing strategy for enterprise customers. The PC PerformancePlan is a traditional, fair market value lease based on the aforementioned higher residual values and is designed to provide enterprise customers with the most aggressive pricing. The PC PerformancePlan Plus is a structured fair market value lease with capped renewal options and "like for like" substitution and will be targeted to customers that have trouble tracking PC assets. The third major program, Price Per Seat, is a program that combines equipment, warranty or maintenance, and other services into a single invoice per unit of equipment. Price Per Seat billing continues to fill a need for a group of very large enterprise customers.

- ☒ Recognizing that SMBs represent an important and growing segment of business, IGF has revamped its program to better meet this market's requirements. Specifically, the company reports changes such as a simplified application process, two-page lease contract, one-hour credit turnaround, and deemed acceptance. IGF concluded it would be more effective and timely to retain an independent third party to implement its revised origination process. However, IGF continues to approve credit, determine the underwriting criteria, administer the lease, and manage the end-of-term processes. The U.S. program is already in place; the European program is expected shortly.
- ☒ IGF pays Lenovo a fee based on its end-user leasing activities. The companies have also announced a range of other marketing programs and organizational measures to link sales incentives, deal tracking, messaging, and marketing activities.
- ☒ IGF will continue to provide inventory financing to distribution channel partners. The company reports financing several billion U.S. dollars of product annually.

## **FUTURE OUTLOOK**

A wide range of companies continue to acquire IT equipment and services through structured financial instruments. IDC estimates that 20% of commercially deployed IT equipment in the United States continues to be leased or financed. We believe that PC leasing will continue to be utilized by a broad spectrum of companies to address a wide range of business problems. That we expect IGF to lease \$1 billion of IBM-brand PCs and laptops annually neatly underscores this point.

IGF's latest program announcements tune the company's program offerings to meet differing customer needs. For end-user organizations that have trouble tracking their deployed IT assets, we believe that the PC PerformancePlan Plus program with its capped renewal options and "like for like" exchange are welcome features in a market where financing options are often less flexible.

We believe that IGF's continued commitment to this market will reassure other leasing companies that PC leasing remains an interesting and active market. Successfully structuring, administering, and managing large portfolios of relatively inexpensive assets requires a significant investment in people and process. IGF is demonstrating to the industry and customers that it can be done. We believe this alliance serves both companies' purposes well. Lenovo continues to have one of the largest IT lessors supporting its sales and remarketing efforts. IGF and IBM benefit by having continuity, both with their existing customers and in managing their existing portfolio risk. Finally, we believe customers benefit from this business alliance because IGF's active presence in the PC and laptop leasing market means customers continue to have another highly capable company potentially pursuing their business.

As we look into the far distant future, beyond the five-year program agreement, it is difficult to foretell what the parties, Lenovo and IGF, may decide. Regardless of whether IGF continues to operate with a worldwide exclusive or not, the company will remain a key influence in the IBM-brand PC and laptop market for years to come as it manages billions of dollars of maturing lease obligations and used equipment.

As we move into 2006, IDC believes the economic climate will be characterized by rising interest rates, modest macroeconomic expectations, and relatively higher secondary market values for three- and four-year-old IT equipment. These environmental factors, combined with tightening equipment disposal requirements, expanding end-user internal IT requirements such as Sarbanes-Oxley compliance, and generally higher levels of business activity, will continue to swing the IT leasing pendulum back to the growth phase.

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