# *Financing the Cloud –*
# A MARKET STUDY

EQUIPMENT LEASING & FINANCE
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# *Financing the Cloud* — A Market Study

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## IDC Opinion

The information technology (IT) industry, which was less than $1 billion 50 years ago, has grown to become the world's largest equipment market; IDC expects that by the end of 2011, worldwide IT spending will exceed $1.46 trillion. Along the way, there have been innumerable revolutions and evolutions, spectacular successes, and head-scratching flameouts, but few of the changes have provoked as intense a debate as IT cloud computing.

Thirty years ago when personal computers (PCs) emerged, some zealots predicted they would replace mainframes — the center of the IT world and the basis for the IT leasing and financing industry. Yet, who could have imagined a future world in which over 400 million PCs would be shipped annually, creating a financing market that exceeds the leasing/financing market for all servers combined, including mainframes?

Bill Gates has been quoted as saying, "We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next 10; don't let yourself be lulled into inaction." In IDC's view, this quote captures perfectly the current IT industry transformation that has been called "the cloud."

IDC believes that IT cloud computing, much like the PC revolution will change and, potentially, expand the industry, requiring billions of dollars of both traditional leasing and financing products and new types of IT leasing and financing products. And, no, IT cloud computing will not replace mainframes or other on-premise datacenters, at least not anytime soon, but IT cloud computing will certainly bring major industry changes.

In IDC's view, it's critical to understand that the IT cloud is much more than a new technology platform; it will be a major transformation of the IT business model — with critical consequences for the entire IT ecosystem, including the IT leasing and financing providers that fund over $100 billion annually in IT acquisitions worldwide. Key IDC findings are as follows:

- IDC expects that by 2015, public and private IT cloud infrastructure spending will top $32.3 billion.
- Public and private IT cloud systems are as much a different IT business model as they are a unique technology platform; they include the same components but have material differences, including relatively higher software content and much more modular (and easily replaceable) equipment.
- By the end of 2011, about 15% of IT industry revenue, and over one-third of industry growth, will be attributable to public and private cloud service deployment.
- Financing will be a critical component for cloud. End users surveyed for this study indicated that they view their financing partners as key allies in this transition. Underscoring this point is the following end-user survey result: 32% of the IT buyers surveyed will use an external leasing or financing source for their cloud project.
- IT leasing and financing providers are adapting to the cloud IT infrastructure at different rates, with vendor captives moving faster. A majority of the IT buyers surveyed (69%) named a vendor captive as their primary funding source; 44.8% said a bank would be their primary funding source, and 34.5% named an independent lessor.

## Introduction: An IT Cloud Primer

***IT Cloud Computing Infrastructure Buildout***

Worldwide, both end-user IT organizations and public IT cloud hosting companies, a new class of IT service provider, are aggressively investing in new IT infrastructure to enable them to provide cloud computing to their own organizations or to enable them to offer it as a business service to customers.

IDC expects that in 2011, worldwide spending to build out both internal (private) IT cloud infrastructure and public IT cloud infrastructure will exceed $12.7 billion, with more than 70% of that in the United States. IDC expects that by 2015, public and private IT cloud infrastructure spending worldwide will top $32.3 billion. In 2015, 58% of the spending ($18.9 billion) will be for private IT cloud infrastructure. For IT leasing and financing companies, this infrastructure buildout presents an expanding segment with positive long-term financing prospects. In the longer term (i.e., by 2015), both private and public IT cloud infrastructure spending will accelerate in other geographies, with U.S. spending falling to about 50% of the worldwide market. IDC believes that Asia/Pacific will likely emerge as the second largest market after the United States.

***Public IT Cloud Services: A New Computing Model***

While the private IT cloud infrastructure continues to grow, a parallel but unique market will emerge rapidly: public IT cloud services. Both IT organizations and consumers have begun buying IT computing resources — including computing and storage resources — from third-party service providers (not unlike old-fashioned timeshare services). Worldwide, customers will spend $29 billion on public IT cloud services in 2011 — up 30% from 2010 — and $55 billion by 2015. This IDC forecast represents the commercial sector only. We have removed all consumer products in this public IT cloud services forecast. IDC believes that commercial IT buyers will rapidly acquire computing resources for cloud email, collaboration, application development/test cloud services, and infrastructure services, and cloud infrastructure will expand to a wider range of business applications.

IDC believes small and medium-sized businesses will lead the adoption of this trend; i.e., acquiring computer resources from third-party providers versus acquiring the computer equipment. For leasing and financing companies, this "new" type of computing: i.e., the use of "public IT cloud services," relies upon a variable usage/billing model that creates an entirely new financeable commodity — public IT cloud compute resources; i.e., "pre-paid" public IT cloud services. IDC expects that financing structures for this market segment will resemble the instruments used today in the office products world, such as price-per-page and utility billing/financing models. That is, financing companies will actually be financing a pre-paid service. Analogous to the way some companies finance computer maintenance service contracts when they acquire new IT equipment. Typically these contracts are paid for in advance and are then bundled together with IT equipment and software, and then sold to financing partners.

For the maintenance companies that provide these services to IT buyers, selling a multi-year service contract to a third-party that bills and collects it provides them with cash for the contract upfront, even as revenue is recognized on a pro-rata basis.

IDC believes that third-party providers of public IT cloud services will seek similar arrangements. Working with a financing partner enables them to draw cash forward to acquire additional equipment to deliver the services even as they recognize the revenue over a period of years.

Through 2014, IDC believes new providers will continue to enter the market for public IT cloud services, and the availability of capital will be a major factor in deciding winners and losers. IT leasing and financing providers — be they captives, banks or independents — have all been approached to provide "buildout" capital for these new companies. These capital agreements are either based on their own financial resources, their business plan (not unlike the leasing/financing of printing equipment companies) or by funding multi-year services contracts.

There is potential for a bubble to form as public IT cloud services providers expand too far ahead of demand. The financial industry, as always, will have to carefully thread the line between capturing expanding new segments and being drawn into a potential overbuilding frenzy.

***Types of Public IT Cloud Computing Services***

Public IT cloud service providers are companies in business to sell computing resources via the Internet to a range of buyers (commercial and consumer) on a unit basis — compute resources (server capacity), storage, and connectivity. Many companies have already entered this business, including Amazon, Google, HP, IBM, and Oracle. In addition to these providers, IDC expects telecommunications companies to be major IT cloud infrastructure service providers and emerge as major resellers of public IT cloud services.

IDC's research results in a compound annual growth rate (CAGR) of 26%+ for the IT cloud.

Although the technical distinctions may not seem important for IT leasing and financing providers, it should be noted that public IT cloud computing services come in a variety of forms. IDC believes that it will become increasingly important for IT leasing and financing providers to realize these distinctions as they enter into the business of financing/billing public IT cloud services (using models similar to the copier cost-per-page model). Understanding the different providers and services models will be essential to determining essential use criteria and accurately assessing transactions risk.

Detailed below is a brief description of these differences, which readers may have encountered when discussing cloud computing:

- **Cloud Service Consumers** are the users of cloud services. These consumers may select/use/pay for services. The definition may include another cloud service provider to other consumers. Three consumer types are discussed, each using applications in the category of SaaS/PaaS/IaaS.

- **Software as a Service (SaaS)** is defined by the National Institute of Standards and Technology (NIST) as "the capability provided to the consumer to use the provider's applications running on a cloud infrastructure." For example, in our research practice at IDC, we have seen select systems management software segments where 35–40% of new license revenue is already being derived from IT organizations opting to have a third party host the software using a SaaS model versus hosting the new application internally.

- **Platform as a Service (PaaS)** is the capability to deploy onto the cloud infrastructure consumer-created applications or acquired applications created using programming languages and tools supported by the provider. Many enterprise software providers are now building out PaaS offerings for IT organizations currently using the providers' software products.

IDC expects many software companies will aggressively promote these types of services, including major players such as Microsoft and Oracle.

- **Infrastructure as a Service (IaaS)** is the capability to provision processing, storage, networks, and other fundamental computing resources where the consumer is able to deploy and run arbitrary software, which can include operating systems and applications. Of the three options, this is the most straightforward — the provisions to maintain IT compute resources such as storage, database, middleware or hosting environment for virtual machines that are consumable on a variable basis.

***Technology Differences Between Cloud and Traditional On-Premise IT Systems***

Although IT cloud computing uses many familiar technologies and components, these systems are different from current technology in that there is additional "separation" between the hardware and application software, making it much easier to shift processing loads between and among systems — even in real time — and between individual systems or even datacenters. This additional flexibility enables cloud computing systems to be more fault-tolerant as well as adjust to rapid shifts in computing load.

The key technologies involved include virtualization (of servers and software), x86 server technology, system standardization, portability of software, and significant new system automation software.

Because there are additional layers of software within a typical cloud computing system, the percentage of hardware in a typical transaction, as well as the amount of hardware that is financed, is reduced as part of the overall transaction.

When one thinks about a cloud computing datacenter, it is better to think of the entire datacenter as the "system" and each server or storage device as a component. For example, with many cloud computing architectures, individual servers or storage systems can be unplugged and replaced in real time.

With the increase in equipment portability and shift away from proprietary vendor platforms, there will be a movement away from a devices mindset, resulting in a change in thinking about the overall IT system. This new way of thinking is about the datacenter as the system with servers as components in that new dynamic. It's important to understand this new mindset because it represents a break away from the hardware and a shift to the overall solution.

For IT leasing and financing providers, this additional separation between the hardware and software potentially reduces the stickiness of equipment at the end of the lease term, with implications for end-of-term portfolio dynamics.

***IT Buyer Benefits Reaped by Private and Public IT Cloud Computing***

- Because both public and private IT cloud systems are much more automated than traditional IT systems, much less IT organization labor is required to sustain them. Reducing IT labor cost is a major driver of IT cloud economics. Consider this: Labor costs account for more than 50% of a typical IT organization's budget. For organizations that use more advanced software to automate the control of IT cloud computing, infrastructure costs can be reduced significantly and systems can be made to respond much more rapidly to changing requirements.

- Shifting the IT organization from a model that requires significant up-front capital investments to a variable, pay-as-you-go model is a proposition familiar to IT leasing and financing providers and a key business benefit of using leasing to acquire access to capital equipment. IDC expects the use of public IT cloud services will enable IT organizations to move to a variable consumption model, thus minimizing capital cost. This will be one of the key shifts IT vendors and leasing and financing providers will see near term.

IDC continues to discuss the combinations of increased pressure on IT budgets and CIOs to reduce the costs of IT. This focus on costs is one of the core messages behind the IT cloud and will result in a push toward more self-service and less operator intervention; labor continues to be one of the biggest costs and concerns for IT operations.

***IT Cloud Relevance: IT Business Model Transformation***

In IDC's view, the cloud cannot be sufficiently understood as a standalone phenomenon in the IT market; rather, it should be considered a core ingredient of a larger transformation of the IT industry and the many other industries using IT to transform themselves. We believe it's critical to understand that the IT cloud is much more than a new technology platform — it is a major transformation of the IT business model.

The IT cloud shift will have as significant an impact on the IT industry as the move from propriety architectures to open computing during the early 1990s. The ramifications will be felt by all players within the IT business — including the leasing and financing industry. For leasing and financing providers, some of the ramifications of this shift to IT cloud computing will require changes in mindset. In particular, leasing and financing providers will be financing more intangibles such as software and services as the product mix shifts.

Additionally, offering a variable usage/billing model (one that creates an entirely new financeable commodity — pre-paid public IT cloud services) will become a market option, creating new financing requirements. IDC expects that financing structures for this market segment will resemble the instruments used today in the office products world, such as price-per-page and utility billing/financing models. However, IDC does not expect cloud offerings to significantly affect current equipment leasing and financing models until 2015. IDC believes that at that time, these technologies likely will have matured to the point where they will begin to affect portfolio behaviors.

Over the next few years, the $120B IT leasing and financing market will exhibit evidence indicating the market shift to the cloud. This evidence may be customer anecdotes, discussions or events that point to the cloud market transition but will not yet dramatically change the way business is done. It's these macroeconomic indicators that will be the markers for IT leasing and financing companies that the IT cloud market transformation is underway.

Through 2014, IDC expects that most leasing/financing providers will witness telling market events, such as the opportunity to finance cloud infrastructure for individual companies or public cloud providers. However, for most mainstream providers, this will likely not become a dominant requirement and will be accommodated within the normal flow of business activities. Further, through 2014, IDC does not anticipate that individual companies will materially alter their acquisition, deployment or use of on-premise IT equipment.

By 2015, IDC expects IT markets will reach the tipping point. Companies will begin acquiring material fractions of their IT compute resources from third-party providers to the point that it will become a factor in understanding and predicting end-of-term portfolio dynamics; i.e.,

the percentage of equipment extend, replaced or returned.

For IT leasing and financing providers working with public IT cloud service providers, IDC expects new financing structures will have emerged and new "standards" adopted by a material fraction of market participants.

Fundamentally, the IT cloud revolution represents a transition to a new IT business model as well as a new technology platform, and IDC believes this will impact directly both IT vendors and the IT leasing and financing industry. For IT leasing and financing providers, this means transitioning from providing capital to a broader spectrum of end-user services including functioning as a [financing] service provider. In our opinion, the change will be enormous and the potential implications far-reaching.

## In This Study

In its effort to better understand the size of the IT cloud computing market, trends in this space, and expected impact on leasing and financing, the Equipment Leasing & Finance Foundation commissioned IDC to research and evaluate these issues. This study is based on the data compiled from two separate research efforts: a Web-based survey of more than 59 North American IT decision makers and in-depth interviews with seven senior executives of IT leasing and financing companies. IDC discusses in detail information about attitudes and trends for public and cloud financing. The study also draws on IDC's IT industry research.

## Methodology

IDC recently completed a Web-based survey of 59 North American IT decision makers who were very familiar with the cloud projects and initiatives within their organizations. All participants represented organizations with 500 or more employees. For the purposes of this analysis, private IT and public IT clouds were defined as follows:

- **Private.** Datacenter environments that enable internal IT resources to be dynamically pooled and shared across multiple physical and virtual computing resources via use of automated management tools in much the same way public cloud services from Amazon, Google, AT&T, and salesforce.com share computing resources across multiple customer accounts.

- **Public.** Service shared among unrelated enterprises and consumers; open to a largely unrestricted universe of potential users; designed for a market, not a single enterprise.

Additionally, IDC conducted in-depth interviews with senior executives from the IT leasing and financing industry. These seven senior executives represented a cross-section of vendor captives and bank-owned financing organizations. Interestingly, none of the independent financing companies were willing to participate in the interviews. This study evaluates and summarizes the findings from both the detailed interviews and the Web surveys.

This study also provides a more extensive and in-depth analysis of IT leasing and financing market trends, specifically those affecting public and private cloud financing opportunity. Beyond the comprehensive analytic factors considered in the sizing and forecast, this document draws heavily from IDC's research practice supporting end-user IT organizations, including their technology road maps, acquisition practices, and funding responses. This methodology leverages our extensive knowledge base of IT equipment sales and leasing markets and our broad knowledge of installed base market information.

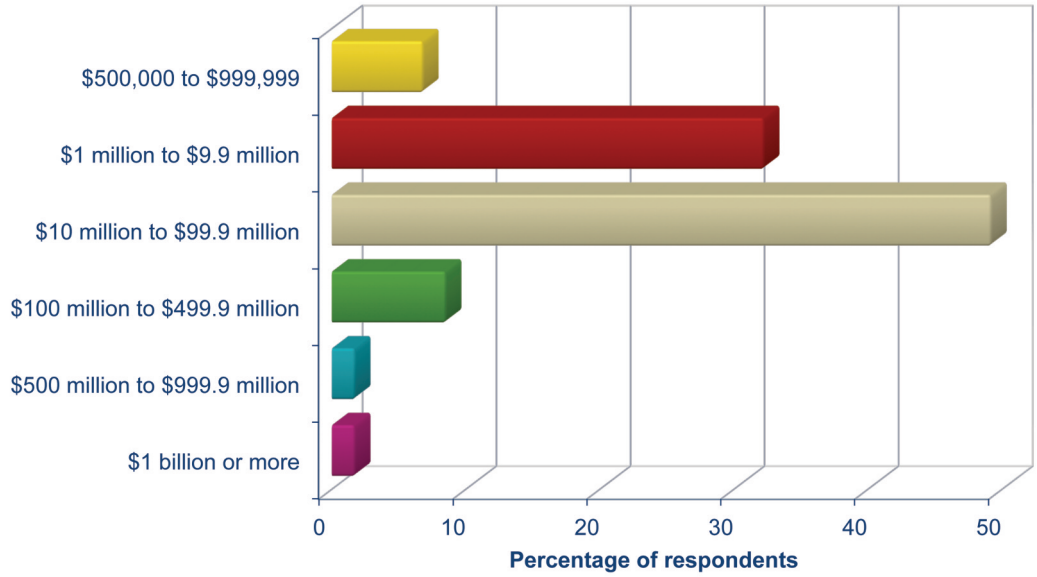
### *Demographics*

The majority of the respondents (49.2%) estimated their overall spending for IT hardware, software, and services in 2011 to be between $10 million and $99.9 million (see Figure 1).

FIGURE 1

**Spending on IT Hardware, Software, and Services in 2011**

*QS5. How much does your organization plan to spend on IT hardware, software, and services in 2011?*



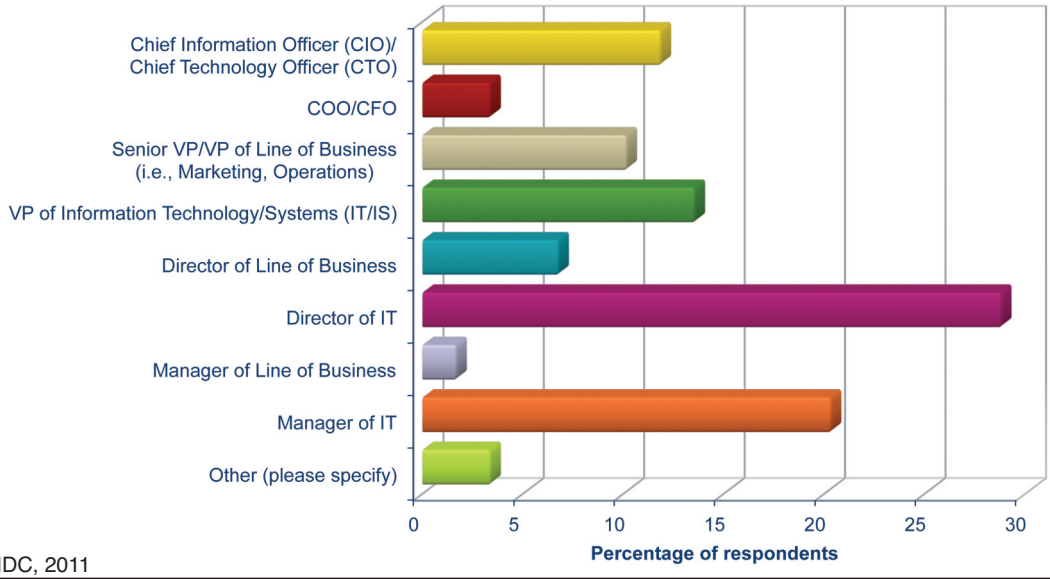

Source: IDC, 2011

Over 50% of the respondents were managers or directors with responsibility for IT or line of business (see Figure 2).

FIGURE 2

**Respondents' Current Title or Role**

*Q1. Which of the following best describes your current title or role?*



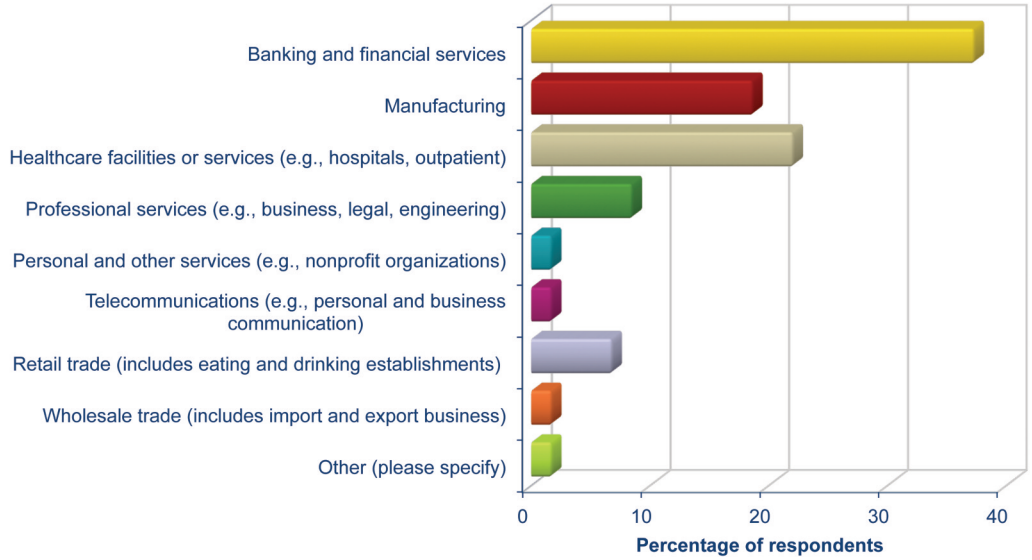

Source: IDC, 2011

Figure 3 shows respondents' primary business activity. The top 3 vertical markets for the survey respondents were banking/financial, healthcare, and manufacturing. These vertical markets are representative of the key segments of the IT markets and indicative of the push in these segments to use IT cloud services to comply with regulatory requirements.

FIGURE 3

**Respondents' Primary Industry**

*Q3. Which of the following best describes your site's/organization's primary business activity?*




Source: IDC, 2011

## Situation Overview

***Leasing and Financing Implications: Sizing the Cloud Financing Opportunity***

As cloud computing continues its rapid technology development and accession to a mainstream computing platform, important questions continue to circulate within the IT leasing and financing ecosystem of captive IT financing providers. Many have expressed concern about the long-term outlook for their leasing and financing services in light of the rapid adoption of IT equipment. While a range of IDC forecasts, from equipment to services, report strong, double-digit CAGRs, IDC does not believe cloud computing, in any of its many forms, will largely eliminate IT equipment from datacenters anytime soon. To the contrary, IDC believes that commercial cloud computing datacenters will actually employ a higher rate of financing than a typical datacenter owned by one organization, although the nature of the financing products employed will be different. In the following section, IDC details the financing opportunity associated with both public and private cloud deployments. IDC believes that the combined impact of the economic recession and an aging server installed base has made this a perfect time for IT organizations to evaluate their future cloud computing investments.

In December 2010, IDC published its first definitive statement about the leasing and financing opportunity for the public and private cloud in *Worldwide Private and Public Cloud Financing 2010–2014 Forecast: Sizing the Cloud Financing Opportunity for Private and Public Cloud* (IDC #226226). The report provided leasing and financing forecasts for public and private cloud

but only as related to servers, storage, and enterprise networking equipment. For ELFF, IDC has updated the methodology to also include the professional services, maintenance, and software components required for both public and private IT cloud infrastructures. These new forecasts provide a more comprehensive assessment of the market opportunity for leasing and financing providers.

- The infrastructure spending to support the worldwide public IT cloud (servers, software, storage, services, and networking) will grow to approximately $13.3 billion, worldwide, from 2011 to 2015. IDC research indicates that this $13.3 billion spent on infrastructure will result in a financing market opportunity of $4.2 billion; i.e., IDC expects that 31.6% of this new IT infrastructure will be leased or financed. From a [financing] market opportunity perspective, this works out to a market that is forecast to grow at a 30.2% CAGR from 2011 to 2015.

- The annual infrastructure spending to support the worldwide private IT cloud infrastructure will grow to $18.9 billion by 2015. IDC's research indicates that the portion of this market that will be financed will grow at a 20.0% CAGR from 2011 to 2015 to reach $5.5 billion.

- While IDC believes that by 2015 a financing market will emerge for prepaid public IT cloud services, as of this writing, we do not believe there is enough information to create a financing forecast. Based on the rapid maturation of this market [public IT cloud services], IDC anticipates the market will be well enough formed that within eighteen months, a formal forecast will be published.

For IT financing companies, funding private and public cloud hardware may create strategic business opportunities and new portfolio dynamics. IDC believes that many of the traditional principles will not apply, such as typical equipment life cycles and remarketing behaviors, because some customers in the public cloud will view their equipment as disposable.

***Private IT Cloud Financing Model***

One of the critical challenges for IT leasing and financing providers financing private IT cloud infrastructure will be the transition to financing a large portfolio of intangibles — in particular and most importantly, the transition to a large number of nonessential use intangibles. In addition, we expect the average deployed life of the software to be much shorter, driven by rapid technology evolution and innovation. This will lead to software that is purchased to enable first-generation private cloud functionality to be replaced twice over five to seven years. This change is compared with the typical life cycle of application software today that stays in place for 10–15 years. The following are other key changes when financing private IT cloud projects:

- Software content as a percentage of total spending will continue to increase. Most deals will include a large component of systems management software to enable private cloud functionality. The bottom line is that comfort with intangibles financing is required to succeed in private cloud financing.

- Private IT cloud systems equipment such as Cisco's UCS, HP's CloudSystem, and IBM's CloudBurst come packaged with significant software content that often makes up more than 50% of the total price. In many cases, this embedded software is not transferable at the end of the lease term to another lessee without significant licensing fees from the vendor.

***Public IT Cloud Financing Model***

Compared with traditional IT financing (where an organization is acquiring specific assets to enable certain software essential to the business organization), the model for providing financing to public cloud services providers is more similar to financing over-the-road tractors for a trucking company or aircraft for a commercial airline. In each case, the leased asset is viewed as a revenue-producing resource. IDC believes that in times of stress, scenarios exist for service providers to return unused or underutilized excess IT equipment that is not producing revenue.

The critical issue in the public IT cloud infrastructure space is that the industry is shifting from a large portfolio of companies with different degrees of efficiency to a model where large amounts of equipment will be held by companies in business to sell capacity on fixed assets. We expect that on average these companies will manage infrastructure more efficiently than traditional IT companies. An example would be financing computer equipment for an outsourcing company such as EDS (now part of HP) versus a midmarket retail company. Furthermore, pay per use or pay per page will become the model for public IT cloud services. Most in the IT leasing and financing industry have experience with this model, but it will need a new twist. As one senior executive at a bank-owned financing company commented, "Cloud players come to us and say 'You guys are very experienced in this and this cost per copy is very similar to this new utility base, so can you just kind of just tweak it and make it work?' So the ingredients are there, but you have to adjust. The models are slightly different; the players are slightly different. So that's the part that I think is going to become more efficient — who does what well, where, and so forth."

## Evaluating IT Buyers' Perceptions of Public Versus Private Clouds

The movement to the IT cloud is already under way, but what is behind this new IT business model? When we asked the senior IT leasing and financing executives what they believed was driving the demand for cloud project financing, there was consensus in the responses. As one senior executive at a vendor captive explained, "The typical commercial customer is only going to do something if there is an economic value or productivity gain to be had. The economics of a cloud installation as a price/performer are what's driving customers to make this decision."

***IT Buyers' Evaluation of IT Cloud Platforms***

To understand how organizations are preparing for the changes that IT cloud will bring to the current IT leasing and financing structures, we asked the survey respondents to discuss their organization's view of public or private cloud projects. First, we asked the end users to indicate if their organization was planning to use a public cloud infrastructure. The majority of the respondents (50.8%) are considering using public clouds or planning to use public clouds in the future. A smaller portion, 25.4%, of the respondents considered public clouds but decided against them (see Figure 4).

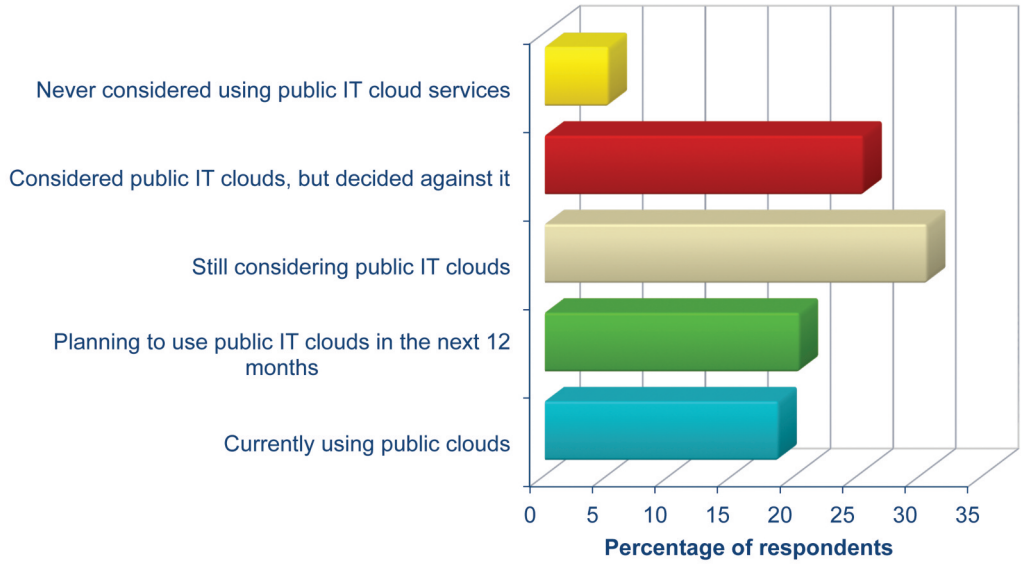
We asked the respondents who were considering public cloud projects to identify the public cloud providers with which they were considering partnering. The top response was salesforce.com, followed by Microsoft (Windows Azure) and Google (Apps).

Additionally, the top vertical markets interested in using public clouds were banking/financial, healthcare, and manufacturing (process and discrete). As mentioned previously in this study, the applications that are already moving to IT clouds are email, collaboration, application development/test cloud services, and infrastructure services, For customers that are facing the combined juggernaut of exponential data growth due to regulatory requirements

FIGURE 4

**Respondents' Approach to Public IT Cloud Computing**

*Q8. What is your organization's approach to public IT cloud computing services?*




Source: IDC, 2011

and diminishing budgets, a successful cloud implementation will pave the way for more workloads transferring to lower-cost hosting platforms. However, it's clear that vital corporate data such as personnel and healthcare records or sensitive financial information will not be hosted on public IT cloud infrastructures. No firm wants to be tomorrow's front-page headline about a data breach. When respondents were asked about their concerns in utilizing public IT cloud services, they indicated that security is usually the number 1 IT buyer concern. To this point, many individuals and organizations already have considerable experience with cloud email and collaboration services (think products such as Yahoo! Mail or Microsoft SharePoint). In these cases, the degree of risk can be readily assessed and understood.

Another important growth market for IT cloud services is application development/test cloud services. In the modern IT world, the amount of IT compute resources required to develop new applications and then test them prior to deployment continues to increase. New software must be tested with multiple operating systems, multiple browsers, etc. There is no confidential data in the new software that is being tested, and the requirements change sharply from month to month, day to day, and hour to hour. As a result, test/development is probably the requirement best suited to use of public IT cloud services — and the security risks are minimal.

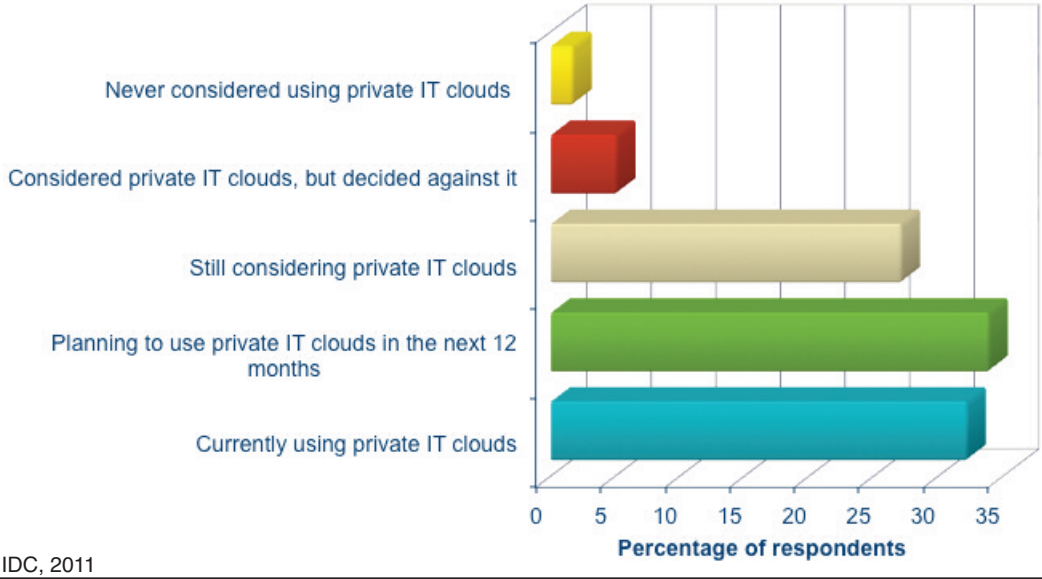
As far as other applications, such as electronic medical records (EMRs) in the healthcare industry, both the IT organizations and the service providers understand the inherent sensitivity of the data and their potential liability if there is an issue. These organizations face a difficult cost-benefit analysis when deploying new technologies — the clear economic benefits of public IT cloud services versus the hypothetical security risks from systems that they have engineered to the highest degree possible. IDC's market research shows that organizations are deploying to the cloud, even with sensitive data, but are doing so carefully and deliberately.

For comparative purposes, IDC also queried respondents about their private IT cloud experiences. 65% of the Web survey respondents are already using private IT cloud services now or plan to do so within the next 12 months (see Figure 5).

FIGURE 5

**Respondents' Approach to Private IT Cloud Computing Services**

*Q11. What is your organization's approach to private IT cloud computing? Private IT cloud refers to an IT strategy similar to that of public clouds, but it is applied within a single enterprise or an extended enterprise as an internal shared set of infrastructure.*




Source: IDC, 2011

This data illustrates a trend we have discussed previously in our research: The movement to private clouds is already under way and some needs are currently being met by either captive financing companies or banks. However, we believe this is a growing opportunity and an attractive prospect for independent financing firms in the IT cloud economy. IDC's reasoning on this point is not only the survey results that verify this as a significant opportunity, with many of the respondents already using private IT clouds. The survey results confirm the staying power of this trend; 43% of respondents replied that it was "very likely" that their organization will utilize a private cloud environment over the next three years, and 40% replied that it was "likely." This data clearly demonstrates end-user momentum toward private clouds (see Figure 6). In addition, the structure of deals for private IT cloud infrastructure closely resembles those that are in place today, further enhancing the opportunity for independent leasing companies.

Earlier we discussed that the private IT cloud infrastructure opportunity is forecast to reach $18.9 billion by 2015, representing equipment required to build and support private IT cloud projects. To succeed in this new area of growth, independent financing firms will need to invest to support the escalating growth in software and services because these two areas will become the more critical components of the private IT cloud, displacing equipment.

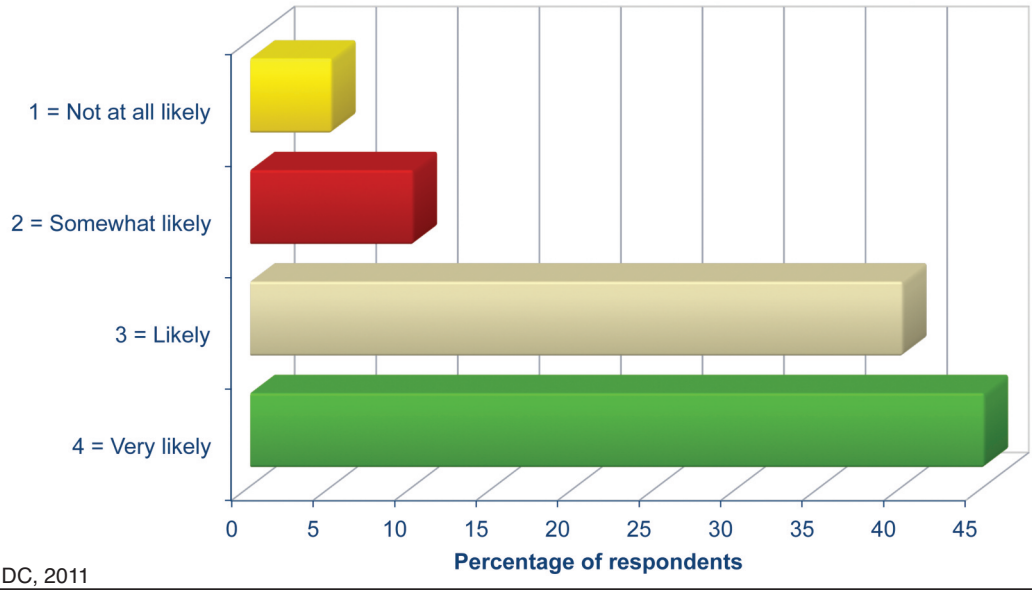
***IT Cloud Limits and Constraints: Security and Reliability***

One of the headline issues surrounding the evolution to the cloud is the debate about the security and reliability of the cloud and, more specifically, security and reliability in public versus private cloud architectures. For this study, IDC asked respondents to rate their per-

FIGURE 6

**Respondents' Likelihood of Using Private IT Cloud Environment in Next Three Years**

*Q12. How likely is it that your organization will utilize a private IT cloud environment over the next three years?*




Source: IDC, 2011

ceptions of the security of public and private cloud computing architectures. The respondents believed that the security of public clouds is a concern, with only 3.4% stating that public IT clouds are "very secure." Contrast this view with the 27.1% of respondents who responded that the security of private IT clouds was "very secure." These results indicate that our Web survey respondents are also trending with the popular thinking on this topic — that private IT cloud architectures are more secure than their public counterparts. The concerns about security are related to the unknown issues of the service provider and the security tools and procedures put in place. It is important to note that this is a key issue for vendors and service providers in the public IT cloud space. As a result, we already see the top players in this area investing significantly to improve both the security and the perception of public IT cloud infrastructures.

Interestingly, when it comes to the issue of reliability, the distinction between public and private cloud architectures diminished slightly. When asked about the reliability of public IT cloud architectures, 39% of respondents indicated that the architectures range from "reliable" to "very reliable," while 66% of respondents indicated "reliable" or "very reliable" for private IT cloud architectures. Dissecting this data about reliability, one can conclude that the IT equipment for public and private clouds is regarded as recognized equipment types from known entities. To further frame the discussion about security and reliability in the cloud, we point to another recent IDC survey entitled *Future Proofing the Cloud*. In this study, nearly half the respondents felt that major cloud providers will have addressed the uptime concerns so effectively in the next three years that reliability will be a nonissue in moving enterprises to the cloud. Furthermore, the findings also show that most respondents believe security — a chief impediment to cloud services — will become a major accelerator by 2015.

## IT Buyers' Comments on IT Cloud Leasing and Financing Offerings

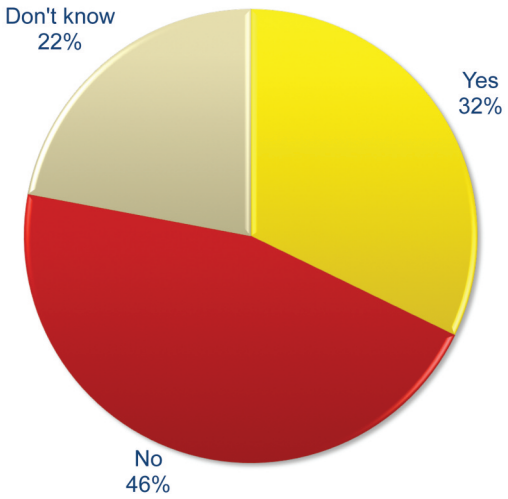
Financing demand for IT cloud infrastructure projects is strong as end users continue to look for a trusted advisor/partner to work with as they embark on IT transformations. For IT leas-

ing/financing participants of all stripes — independent financing companies, vendor captive, or bank owned — IDC believes that, based on our survey data and direct conversations with IT buyers, these potential clients are looking for trusted partners to help with this transition. Underscoring this statement are the end-user survey results: 32% of those surveyed will use an external leasing or financing source for their cloud project initiative (see Figure 7).

FIGURE 7

**Respondents Who Plan to Use External Leasing or Financing Sources**

*Q14. If your company is undertaking a cloud project initiative, will you use external leasing or financing sources?*



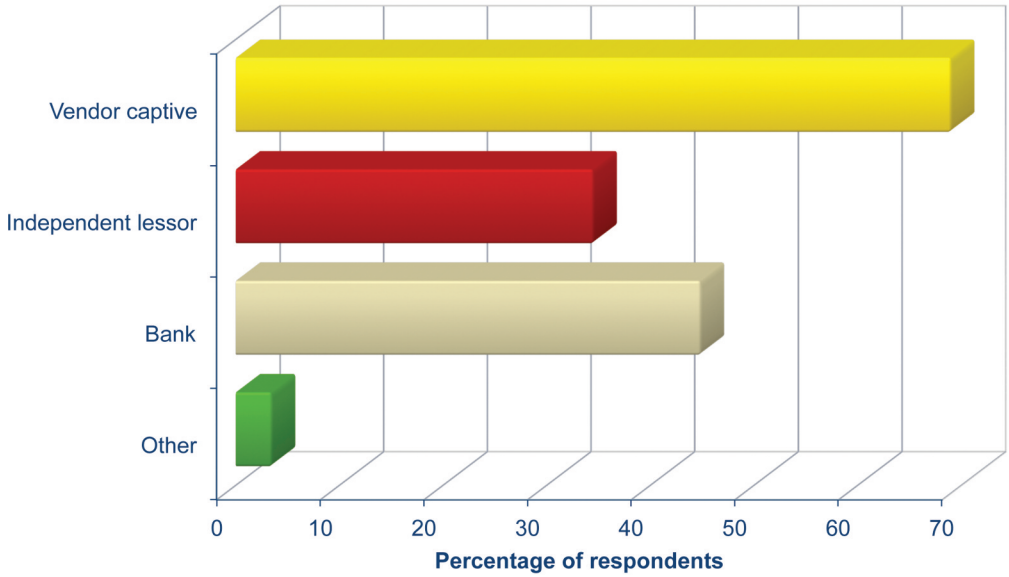

Source: IDC, 2011

We then asked the respondents which type of leasing or financing firm they would work with to fund this IT cloud initiative. The majority (69%) named a vendor captive; 44.8% said a bank would be their primary funding source, and 34.5% named an independent lessor (see Figure 8).

FIGURE 8

**Respondents' Preference for Equipment Leasing/Financing Provider Type for Cloud Projects**

*Q14. If your company is undertaking a cloud project initiative, will you use external leasing or financing sources?*




Source: IDC, 2011

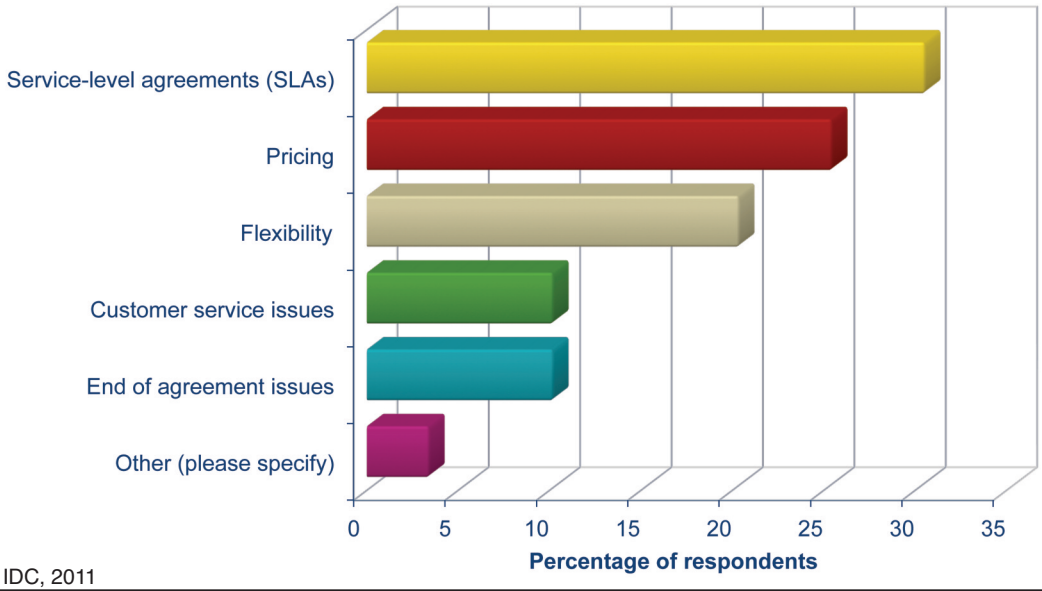
In our view, the sophistication of financing offerings and the willingness to act as a trusted advisor will be key determining factors for IT leasing/financing providers' success or failure in this multibillion-dollar financing opportunity.

To obtain some background about the use of financing for IT cloud projects, we asked respondents which department made the leasing and financing agreements for the company. Over 52.5% said the finance department. Probing further, IDC asked about their view of the top challenges in managing leasing and financing agreements (see Figure 9).

FIGURE 9

**Respondents' Top Challenge in Managing Leasing and Financing Agreements**

*Q24. Which of the following is your organization's top challenge when managing your external leasing/financing agreements?*




Source: IDC, 2011

In our view, as customers begin the transition to the IT cloud, it's not surprising that service-level agreements and pricing would be challenges. Analyzing these responses with the other survey data, we find that customers are relying on their financing partners to make this IT business shift but are still constrained by budget pressures — all of these factors lead to an increased level of scrutiny on variable costs.

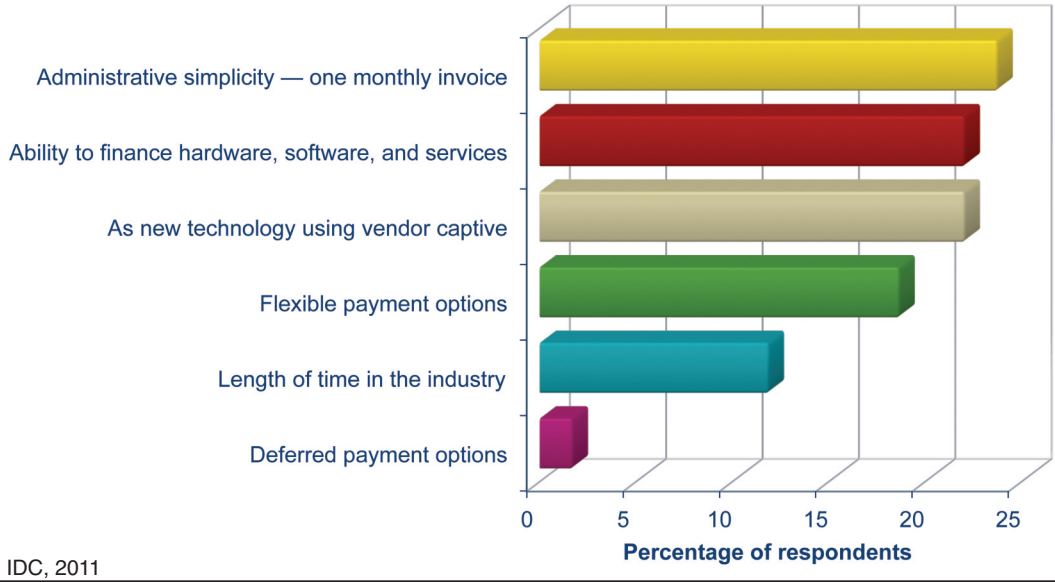
### *Selection Criteria*

In an effort to further distinguish the selection criteria when deciding about funding sources, we asked the respondents to rate the key principles used when selecting a funding source for cloud projects (see Figure 10).

FIGURE 10

**Key Selection Criteria in Choosing Financing Provider for Cloud Projects**

*Q16. Regardless of whether you would use external financing or not, when selecting a financing provider for cloud projects, which of the following do you think would be the key selection criteria?*




Source: IDC, 2011

This most recent survey has reaffirmed that a key IT buyer selection criterion is administrative simplicity (i.e., a single monthly invoice that includes the lease payment for the equipment and the monthly maintenance fee to the manufacturer [or service provider]).

The requirement that the provider have the ability to fund all aspects of the project clearly provides an edge to the captive funder. And the additional concern that it's a new technology initiative gives the IT organization an added incentive to go with the vendor captive. Certainly these are valid responses when undertaking a shift to a new technology. However, we still believe that opportunities exist for all IT leasing and financing players, if they are willing to adapt to new procedures and business requirements.

Both IT organizations and emerging public IT cloud service providers seeking funding to build out cloud infrastructure continue to struggle with the capital requirements, technology issues, and uncertainty of demand. As a result, IDC has noted requests for much more flexibility in leasing/financing contracts. Whether it is a more traditional leasing instrument with a utilization/put-back clause or an open-ended "leasing as a service" structure, the combination of world economic events and IT industry stresses is impacting the traditional financing models. IDC believes that challenges to the traditional 36-month IT lease structure are a change IT cloud computing has already brought to the IT leasing/financing industry — a change that is here to stay and that will likely accelerate in years to come.

**IT Leasing/Financing Guidance**

For all types of IT leasing/financing providers, whether they are captives, independents, or banks, the leasing/financing offer is generally a balance of business relationships, risk appetite, and administrative capabilities. The key findings shown in Figure 10 reinforce many expectations but perhaps challenge others. The choice to finance a project that consists of hardware, software, and services is a function of the provider risk profile and other internal risk management considerations that are unique to each financing company.

Of course, it is easy to rationalize and understand an expressed IT buyer preference for administrative simplicity (i.e., a single monthly invoice). Yet many providers — even many of the captives — have not invested by creating the business relationships and backroom administrative capabilities necessary to provide integrated billing. For all providers, including independents and banks, it is important to recognize and understand that administrative simplicity is a point of business differentiation that is valued by buyers and underexploited in the marketplace.

The third most highly rated preference, use of the captive because the technology is new (and deemed to have more inherent risk for the IT buyer), demonstrates an attempt to shift risk. Although actual contractual documents likely provide no real risk relief, the belief among IT buyers is that they will have some incremental advantage when dealing with a captive — documented or not. Of course, IT buyers vary widely in their ability to manage complex technological projects. Many large IT shops are highly sophisticated and have excellent track records; others not so much. For independents and banks, being deselected from a particular transaction because of a perceived but probably not real ability to remediate incremental risk is, perhaps, not a bad thing.

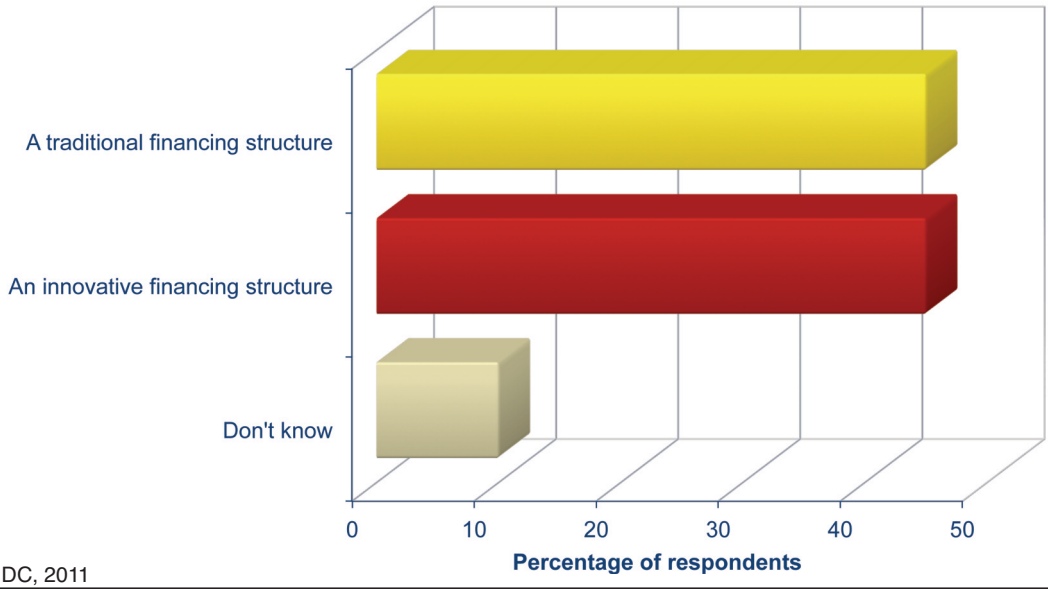
### *Are Current Offerings Meeting Customer's Needs?*

Understanding the current financing structures of IT cloud projects was an important research area for this study. Analyzing the results from the Web survey revealed that the current financing offerings for IT cloud projects are a combination of traditional structures (45%) and new, innovative structures (45%) (see Figure 11).

FIGURE 11

**Use of Traditional or Innovative Leasing or Financing Structure for Cloud Projects**

*Q25. Did the financing company that your firm worked with on your cloud project utilize a traditional leasing or financing structure for the cloud IT services or a financing structure tailored to the cloud project? They used...*



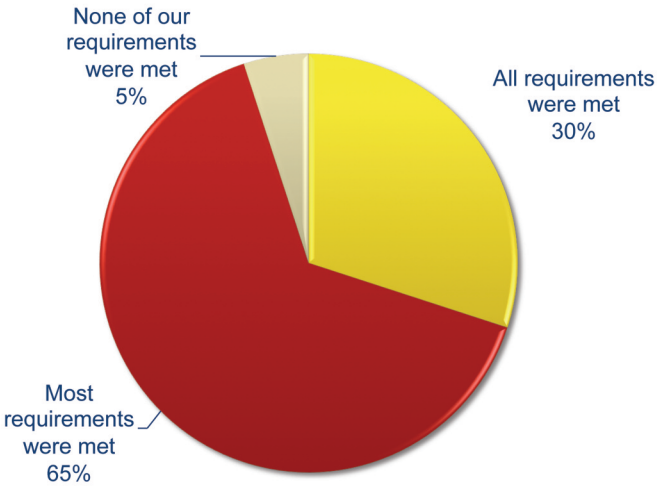

Source: IDC, 2011

Additionally, the results indicate that the majority of the respondents (65%) believed that most of their needs were met, and 30% responded that all of their needs were met (see Figure 12).

FIGURE 12

**Respondents' Needs Met and Unmet by Leasing and Financing Providers for Cloud Services Financing**

*Q17. You mentioned that you leased or financed public or private cloud services in the last 12 months. Do you believe all of your financing requirements were met?*



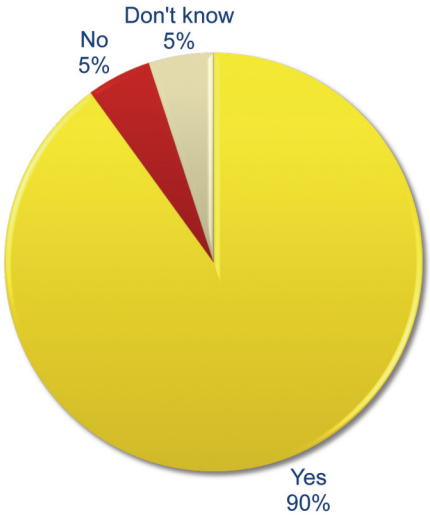

Source: IDC, 2011

Furthermore, 90% would recommend leasing or financing their next project based on their experience. These results indicate a high level of satisfaction with the cloud funding programs that are available today (see Figure 13).

FIGURE 13

**Respondents' Likelihood of Recommending Leasing or Financing on Next Cloud IT Project**

*Q18. Based on your experience, would you recommend leasing or financing the next cloud IT project?*




Source: IDC, 2011

IDC expects that clients' future needs will require a new blend of financing products, which will increase the use of pay-per-use and metering tools as well as increase the comfort level with intangibles financing.

Respondents were asked to name the top 3 leasing or financing providers that came to mind when considering a cloud project. The results followed the trends already established by the respondents: Going with a vendor captive was the safest choice because IT cloud projects were new programs/technologies. For the Web respondents, IBM was the top response, followed by HP. The number 3 and 4 responses were Wells Fargo and Bank of America, signifying that banks were the next choice for a financing partner. In our opinion, these answers about satisfaction with IT cloud offerings and the blend of traditional and innovative financing structures are consistent with current thinking about the structure of IT cloud transactions. The IT leasing and financing market is responding to the new expectations and demands of its customers. In fact, the majority of the senior executives interviewed for this study remarked that if a traditional structure will close a deal, that is what is offered. Alternatively, if a more innovative program is required to win the business, then that becomes the structure of the deal. Typically, the foundation for many of the more innovative structures is a pay-per-use or utility-type model that enables customers to acquire additional capacity as needed and, most importantly, provides the client with an increased level of flexibility.

When analyzing the types of transactions used for private and public IT cloud transactions, senior financing executives also weighed in about the different offerings. With the demand for cloud computing programs and financing still in the early adoption phase, end users, service providers, and lessors are still defining and designing offerings for this space. As a result, the terminology is not yet clearly defined. And IDC believes that we will be in this transitory stage for another two to three years. As one senior financing executive explained, "I've got projects going on practically in every one of these areas [cloud IT hardware, cloud IT infrastructure, cloud IT for service providers], and I'm trying to get it down from 300 flavors to 31 flavors. If I could just get it to 31 flavors, just kind of coining Baskin-Robbins here, but maybe that could be manageable and we could find a way to scale that a little bit better. So far, every deal that's come in has been a little different." This quote represents one of the biggest challenges facing financing companies working in the cloud space right now: Every deal is different, so it's difficult to obtain economies of scale with programs and offerings. Furthermore, this issue was consistently brought up during our senior executive interviews, whether or not the respondent was representing vendor captive or bank-owned firms.

**Impact on Existing Financing Models**

Another issue that IDC was asked to investigate in the study was the anticipated impact of IT cloud computing on current programs and, more importantly, whether leasing and financing firms will be able to leverage current programs and intellectual capital when structuring programs for the cloud. Specifically, we asked the IT financing executives about pay-per-use programs and their applicability for funding IT cloud projects. Overall, most respondents stated that the IT cloud financing programs were still in development and that; in the meantime, they are using their current programs. When specifically asked about pay-per-use models, one senior executive remarked that "it's still a work in progress; customers want flexibility with predictability." Another executive added, "Everyone is looking for higher levels of productivity, shifting risk and responsibility for equipment. I think there is just a big move to shift risk and responsibility to providers, getting it off the balance sheet, matching revenue to expenses. We are getting into usage-based stuff here, which is becoming a bigger and bigger driver. Doing that without paying a premium is another thing — that's where the rubber meets the road."

***Inside Workings of the Vendor Captives***

For vendor captives, working closely with different parts of the vendor organization often shapes the scope of the deal. More often than not, the services group within the vendor is the primary interface with the customer undergoing a cloud IT infrastructure project, and financing is the enabler. For vendors with more experience in IT cloud services, the relationship with the services organization is a partnership. Vendor captives commented that after structuring many cloud deals, they were able to have the detailed conversations with their senior management explaining the shifts to intangibles financing and the change in product mix that would reshape their business. This shift to IT cloud services goes beyond the scope of just the product mix to also impact tax, accounting, and legal issues.

Regarding the specific implications of back-office issues, one of the senior executives responded, "It's not 70% hardware assets — it's certainly less than 50% — and so we have had to go through some learning on our own and bring our parent company up to speed because there could be, historically there had been, revenue recognition challenges. Without giving too much detail, we worked through a number of those issues successfully; we've gotten the freedom and support to be in the business that we need to be in, in order to support our cloud infrastructure."

## Future Outlook

IT equipment and software will account for over 42% of all spending for equipment in the United States during 2011 — the single largest collateral type — and through 2015. IDC expects that U.S. IT spending will grow at a CAGR of 5.2% from 2011 to 2015. The buildout of public/private IT cloud infrastructure and the emerging opportunity of financing IT cloud services will once again challenge the IT leasing and financing community — a community upon which the IT industry relies heavily as a critical source of business capital.

IDC believes leasing and financing companies are being presented with an important "fork in the road" as a major industry morphs and evolves. Many leasing/financing providers will embrace the change and strengthen their market positions; others may choose to wait until the market matures and clear winners emerge. IDC believes that as uncomfortable and potentially confusing as IT cloud computing seems in its current forms, these market segments have reached the multibillion-dollar threshold, and based on that, it is time for providers to begin pursuing these financing opportunities because they account for almost half of this market's net growth.

## Essential Guidance

The technology that enables IT cloud infrastructure, whether public or private, is developing rapidly. Therefore, terms, definitions, and best practices continue to evolve — and rapidly — as the industry goes through this period of technology transition, market evolution, and supplier definition. IDC expects that three to five years will pass before definitions and nomenclatures become standardized.

IDC believes that, notwithstanding this period of rapid technology and business model evolution, IT leasing and financing providers should not make the mistake of assuming it should be avoided. Rather, IDC believes that now is the time that key market positions are being established. These positions will likely shape the industry for the next 10 years and beyond. The following key issues will change the current views and practices of both the IT market and the leasing and financing of IT:

- In the short term, the biggest challenge to the leasing and financing industry is the amount of cash on hand at Fortune 500 companies. Currently, IDC continues to see smaller IT acquisitions paid in cash (those below the $250,000 price point). However, we anticipate that the pendulum on cash hoarding will shift to leasing and financing over the next 24 months, as end users look to leasing as a means to limit their risk exposure for IT equipment and solutions, especially in this time of IT technology transition and uneven economic performance. Broadly, concern about the economic outlook is the reason that organizations are maintaining unusually high cash balances and that many IT segments continue to see strong demand for IT leasing and financing products, even in the face of record-low interest rates. The point of these two countervailing trends is that macro-economic uncertainty is causing volatility in demand for IT leasing and financing services. Based on how various domestic and international issues play out, leasing demand will remain volatile for the next three years.

- Financing demand for IT cloud infrastructure projects is strong as end users continue to look for a trusted advisor/partner to work with as they embark on these IT transformations. For IT leasing/financing participants of all stripes, independent financing companies, vendor captive, or bank owned, IDC believes that, based on our survey data and direct conversations with IT buyers, these potential clients are looking for trusted partners to help with this transition. Underscoring this statement are the end-user survey results: 32% of those surveyed will use an external leasing or financing source for their cloud project initiative. The sophistication of financing offerings and the willingness to act as a trusted advisor will be key determining factors for IT leasing/financing providers' success or failure in this multibillion-dollar financing opportunity.

- The opportunity for independent financing firms in the IT cloud economy is the private IT cloud space. The survey results verify this opportunity: 43% of respondents replied that it is very likely that their organization will utilize a private cloud environment over the next three years, and 40% replied that it is likely, clearly demonstrating a positive trend. Earlier we discussed that this opportunity is forecast to reach $18.9 billion by 2015, representing equipment required to build and support private IT cloud projects. To succeed in this new area of growth, independent financing firms will need to invest to support the escalating growth in software and services, as these two areas will become the more critical components of the private IT cloud, displacing equipment.

- The current financing offerings for IT cloud projects are a combination of traditional tools and new innovative structures, and 65% of the survey respondents stated that their cloud financing needs are met with these two offerings. Furthermore, 90% would recommend leasing or financing their next project based on their experience. IDC expects clients' future needs will require a new blend of financing products that will increase the use of pay-per-use and metering tools as well as increase the comfort level with intangibles financing.

- Both IT organizations and emerging public IT cloud service providers seeking funding to build out cloud infrastructure continue to struggle with capital requirements, technology issues, and uncertainty of demand. As a result, IDC has noted requests for much more flexibility in leasing/financing contracts. Whether it is a more traditional leasing instrument with a utilization/put-back clause or an open-ended "leasing as a service" structure, the combination of world economic events and IT industry stresses is impacting the traditional financing models. IDC believes that challenges to the traditional 36-month IT lease structure are a change IT cloud computing has already brought to the IT leasing/financing industry — a change that is here to stay and that will likely accelerate in years to come.

IT cloud computing in its various forms will not replace traditional, on-premise IT, but it will certainly affect it — not unlike how PC spending affected mainframe computing strategies 30 years ago. Through 2015, major investments in both private and public IT cloud infrastructure will continue — providing attractive growth opportunities for IT leasing and financing providers; however, the risk of overbuilding, with the attendant credit risk, certainly exists. IDC believes that by that time, IT cloud computing business and technology models will have solidified, key providers will have emerged, and the IT industry will vector in a new and different direction — with yet new challenges for IT leasing and financing providers.

## Acknowledgements

This study was guided by a steering committee of dedicated industry volunteers who gave their time and expertise by providing comments and suggestions throughout the development of the report. Their participation is appreciated greatly. They are: Stephen Guido, Melisa R. Carter, Christopher A. Enbom, Paul W. Frechette, Michele Grieshaber, D'Arcy LeNeveu, John Mayer and David G. Mayer.

## About the Researchers

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Susan Middleton is a research director for IDC's Technology Financing Strategies and Technology Valuation Services programs. Ms. Middleton follows trends, technology changes and market forces that impact life cycles and IT portfolios. She provides insight and guidance to her clients and helps them manage their IT portfolio risk. Ms. Middleton is also the lead analyst on the annual global IT leasing and financing report that sizes the market opportunity in the top 25 geographies.

Susan's more than 20 years of business experience with senior managers, marketing specialists and risk management have provided her with well-tested insights and assumptions that are indispensable for financing and technology executives. As a well-respected thought leader, she is often requested for confidential and private briefings to top executives to discuss strategy and market directions.

***Joe Pucciarelli, Program Director, Technology Financing & Executive Strategies***

Joe Pucciarelli's research focuses on the spectrum of financial and managerial challenges that corporate management executives and financial experts will encounter in the near future in conducting business. With his direction, many Fortune-100 businesses have proactively mapped the changing business requirements and evolved their internal IT and financial practices to provide business value and performance metrics and financial transparency demanded of all business functions.

With more than twenty years of broad-ranging business experience in the financing and technology industries, Mr. Pucciarelli has held a variety of consulting, product marketing, risk management, and senior management positions with companies including Gartner, GE Capital, Peregrine Systems and his own company, ComplianceOfficerForum.com.


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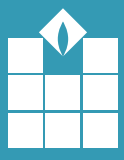

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