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Financing the Cloud – The Time is Now!

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At this year's Equipment Leasing and Finance Association Annual Convention in Palm Desert, Crit DeMent made reference to the opportunities associated with financing cloud technologies. *Equipment Finance Advisor* asked DeMent to speak to the topic in greater detail. In the following Q&A, he discusses the opportunities, the potential pitfalls and the important points to consider when undertaking cloud technology financing.

Equipment Finance Advisor: Crit, in your opening remarks at this year's ELFA Annual Conference in Palm Desert, you focused on the opportunities for the equipment leasing and finance industry that are beginning to come into the forefront with regard to financing the cloud and cloud technologies. Could you give our readers an overview of what those opportunities are and in time will be?

Crit DeMent: The opportunities are substantial and in terms of timing, the time is now.

Before we talk about opportunities though, I think we need to be clear on what the cloud actually is. The 'cloud' will completely transform the IT business model. It is not simply a new technology platform. And it's not a singular term—there are in fact many clouds that fall into two distinct categories.

The first category is the Public Cloud. As the name implies, the public cloud essentially shares IT services among unrelated users such as individuals or companies. These will typically be very large installations of server clusters and the global telecommunications infrastructure that connects them, along with the appropriate software applications for the constituents of that particular cloud environment. It goes without saying that these are very large, expansive—and expensive—installations.

Private Clouds, the second category of cloud computing, are deployed by individual companies and are used only by the employees of those companies. A private cloud is not available to anyone outside of the enterprise. The basic element of a private cloud environment is a reinvented corporate datacenter that combines and shares IT resources throughout the enterprise. The technology that creates a private cloud is very similar to that used for a public cloud. The only real differences are scope and limited access. Companies of any size can deploy a private cloud solution, and will do so in order to reduce overall IT costs.

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In November 2011, the Equipment Leasing and Finance Founation published a study called *Financing the Cloud - A Market Study*. According the study, by 2015 about $13 billion will be spent on the infrastructure for the public IT cloud, with a financing market opportunity of $4.2 billion. Spending on the infrastructure for the private IT cloud will be even larger, approaching $20 billion, with a financing market opportunity of $5.5 billion. From there, spending will clearly continue to increase as the movement to cloud computing continues to grow and the cloud technology platforms continue to evolve.

EFA: In your estimation both as the outgoing chairman of the ELFA and as an industry executive, will equipment finance companies of all sizes be able to seize these opportunities or will these opportunities by their nature, require by necessity, the resources associated with larger equipment finance companies.

DeMent: I believe these opportunities will be open to finance companies of any size because cloud computing solutions will be available for companies of any size. As I've explained, when we refer to cloud computing, we're actually referring to many different clouds. It's also important to note that the experts believe that small- and medium-sized businesses will be at the forefront of cloud computing because it is so cost effective.

The cloud ultimately reduces costs because companies don't need to invest so heavily in IT infrastructure. They can

effectively purchase only the computing resources—including expertise—they need from a third party provider. I think it's interesting to note that this trend presents a new and very unique opportunity to the equipment financing industry. Clients of the cloud will only pay for the resources that they use. So financing the cloud will rely to a large extent on usage-based billing, similar to what is used in the office products arena.

The important point here is that even very small companies can deploy cloud-based solutions. So from this perspective, equipment finance companies intent on funding cloud solutions will most likely wind up doing business with companies of a particular size, just as they do today. The rough parity in size that typically defines the customer-finance company relationship will continue—the only difference will be the collateral that is actually financed.

The key to doing this successfully however will be to help customers to properly deploy a cloud-based solution. That's where finance companies of virtually any size can really capitalize on the opportunities presented by the cloud. I think you need to step out of the typical role of financing partner by being able to offer valuable advice on what the cloud solution should look like and how to put it together, instead of simply funding the transaction. This is particularly true when we're talking about a cost-per-usage billing model for the cloud.

If you can do that, and then turn around and finance the entire transaction, there is virtually no limit on potential revenue. So, even a very small finance company that can master the technology of the cloud and can help its customers to deploy cloud-based solutions will be able to derive significant competitive advantages—and virtually unlimited growth—from this expertise.

I should also point out that size—in this case at least—might not matter. For example, a huge finance company that doesn't fully understand the nuances of the cloud probably won't be able to take advantage of all of the opportunities that are bound to come their way. I think that understanding the underlying technologies and how they come together is far more important than the size of the finance company.

EFA: As you've addressed the opportunities associated with financing the cloud, what in your estimation are the traps or pitfalls that equipment finance professionals need to be aware of as these opportunities continue to present themselves both now and in the future?

DeMent: The leasing and finance industry gets comfortable with financing intangibles, which will ultimately represent a significant percentage of a finance company's portfolio. This is due to an increase in software as a function of total IT spending that will invariably occur as the cloud expands. Also, the increase in software will be fueled by shorter usable life cycles as the pace of innovation picks up. This has always been true in the technology space but will be even more pronounced when considering the cloud. I think this is a big hurdle that the finance industry must face when it comes to financing the cloud because it goes against what many equipment finance professionals are comfortable with.

There's really no way around this. There are essentially three separate components of cloud-based financing—cloud IT hardware, cloud IT infrastructure, and cloud IT services. But you also have to realize that within both the hardware and infrastructure categories, software is an integral component.

I think that in accepting a larger component of intangible assets a finance company's appetite for risk will also come into play. This reassessment of risk when it comes to funding IT projects will undoubtedly become somewhat of a barrier to many finance companies.

Another challenge is the fact that the cloud computing universe is still evolving dynamically, and there is not yet a common language that ties it all together. Because the cloud and the financing for it are still in the early stages of adoption, financing offerings are being created—often on the fly—and evolving very quickly.

The experts predict that this will last for another two or three years, which means that it might be difficult to scale cloud technology financing offerings during that time period. When every deal is different, a finance company's internal costs tend to increase because there are no economies of scale with programs and related offerings.

I think another challenge is one associated with any emerging market, which this clearly is. IT departments are still trying to wrestle with technology issues, not to mention the related capital requirements of cloud-based computing. On top of that, there is the ever-present uncertainty of demand. This will invariably result in the need for tremendously flexible financing programs that can be configured—sometimes dynamically—to meet the rapidly changing needs of the marketplace.

Finance companies that are constrained with very rigid internal structures will undoubtedly have a problem with this. This challenge is underscored by the fact that one of the most important criteria for IT buyers in selecting a financing partner for cloud-based solutions is streamlined administration. A single monthly invoice—as simple as that sounds—is probably one of the most important components of a financing company's successful cloud offering.

EFA: How can an equipment finance company best prepare for these opportunities?

DeMent: Hopefully they've already begun the process, because this market is currently active and cloud funding transactions are now happening every day.

I think step one for any finance company looking to become involved in financing the cloud would be to define a niche. For example, apart from banking and financial services, both manufacturing and healthcare appear to be the largest early adopters of cloud computing solutions. So if a finance company has developed expertise in any of those areas, that would be good place to start.

Beyond choosing a niche, I think entering this space requires a deep understanding of what the cloud really is, and what the marketplace looks like. It's important to understand the magnitude of what we're dealing with here. Computing in the cloud is not an incremental step in the ongoing evolution of technology. It is instead a quantum leap in the way we live our lives and do business.

So to be on the cutting edge and to ride the crest of the cloud technology wave, finance companies will need to dedicate significant internal resources—both human and financial—to fully flesh out and then to capitalize on the tremendous opportunities it represents. Cloud funding offerings must be designed, packaged and rolled out. And when it comes to doing this, time is of the essence.

EFA: Is there anything else you would like to let your readers know with regard to opportunities that this major transformation, as you called it at the ELFA Conference, means to the equipment leasing and finance industry?

DeMent: I think there are two things. One, there is tremendous potential here to build an entire business around financing the cloud. It is huge and we, as an industry, are at precisely the right place and time to take advantage of it. The cloud is not a trend that will soon disappear. It is the future of enterprise computing.

Two, this is also a tremendous opportunity to make our own companies more lean, efficient, and profitable. By shifting our IT services to the cloud ourselves, we can completely reinvent how we operate and do business. We are at the same kind of crossroads we were at when the Internet came along and enabled us to redefine how equipment finance and leasing companies operate.

I truly see this as an exciting time to be in this business. The opportunities are immense.

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