Loan rangers

Buying IT equipment outright is a major outlay, but James Taylor explains that leasing could be a better option for small businesses.

Once, the only way to buy IT equipment was to pay in full before you could even take delivery. If you didn't have the money, you'd have to beg your bank manager for a loan that might only cover the equipment, leaving you to scrounge around for extra money to pay for software and services. But now there are more creative financing options.

You may be lucky enough to be able to pay for your equipment out of your own funds. But this could, of course, blow a big hole in your cashflow forecasts, lose you interest and leave you without a cushion in the event of an emergency. The advantage of splashing out your own cash is that you won't have to pay loan interest or rent. It may also be desirable to have IT as a capital asset on the balance sheet, so it can be used as security for general borrowing – which you can't do with some other forms of financing. The disadvantage is that your IT equipment will be a depreciating asset and will become increasingly obsolete.

You can still own your equipment if you take out a conventional repayment loan, in which case the above pros and cons will apply, except that you will have preserved your cash reserves and relieved the pressure on your cashflow at the cost of having to pay interest on the loan.

An alternative form of financing that involves payments by instalments is leasing. Money doesn't come from a bank but from an independent lending company (the 'lessor'). It pays your supplier and charges you (the 'lessee') monthly or quarterly payments that include an element of interest. Although you pay more for your IT, you get to spread the cost over several years (usually between two and five). During the period of the lease, the goods belong to the lessor, not you. Be warned, though, if you are a start-up businesses, you may be excluded because you can't provide the two years worth of accounts demanded by most leasing companies.

The two principal forms of lease agreement are lease purchase and lease rental. Lease purchase is similar to hire purchase in the domestic field. Having kept up monthly rental payments, the final payment is the residual purchase price. Pay that and the goods are yours. Of course, they may not bring much of an asset value to your balance sheet by then. Also not every leasing company offers lease purchase.

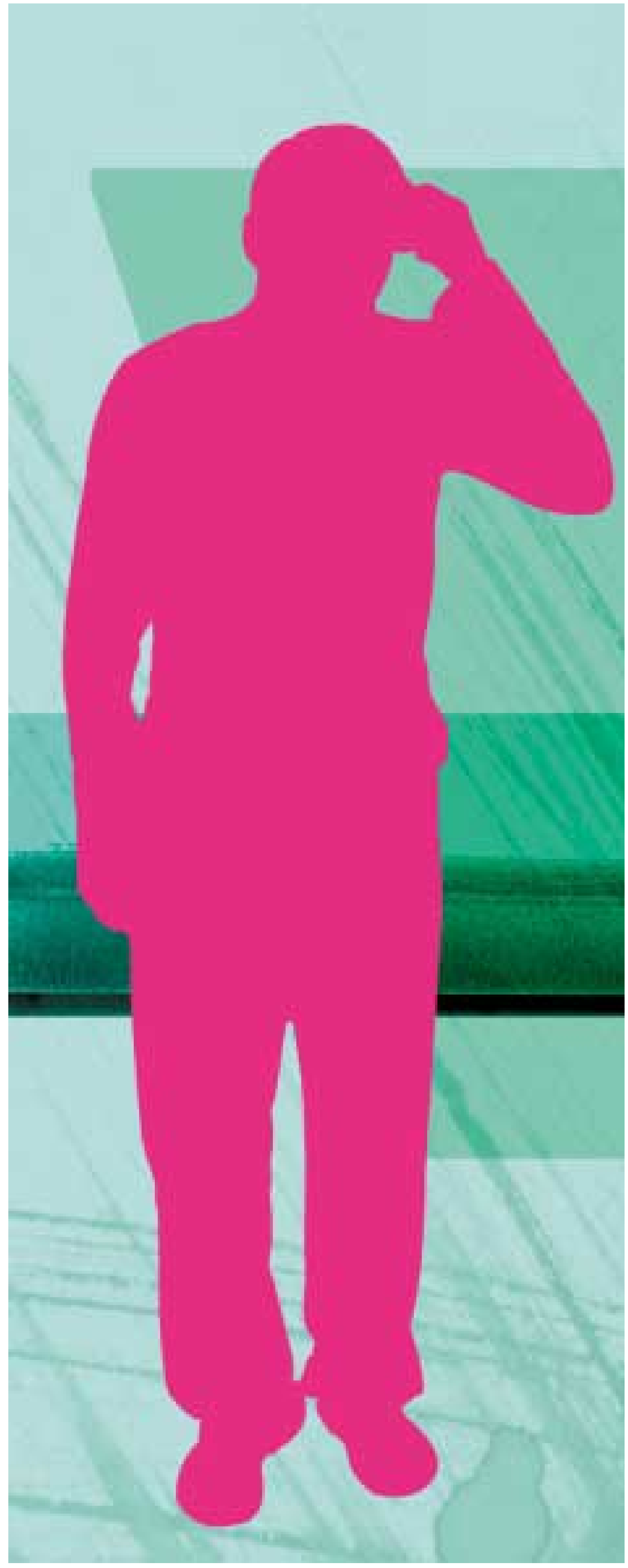


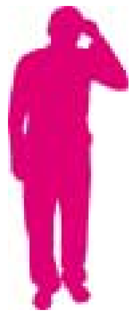
ILLUSTRATION LIZ COULDWELL

Lease rental is by far the most common form of leasing. The main difference between this and lease purchase is that at the end of the lease, the goods remain the property of the leasing company. If you still want to use them, you can pay a much-reduced straight rental charge for as

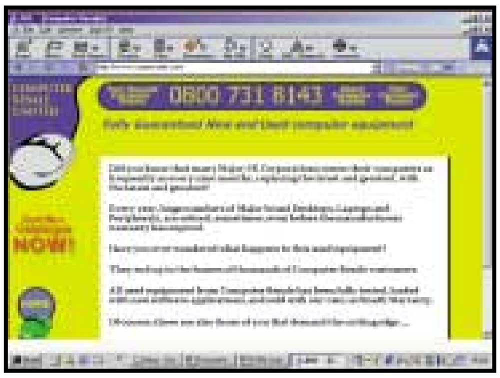
long as you want. Or you can give the goods back to the leasing company, leaving you with nothing (which isn't as bad as it sounds because they're probably at the end of their useful life anyway). Or, as usually happens with goods that have a relatively high built-in obsolescence, you can exchange the old kit for new equipment and start again with a new lease. Leasing helps cashflow by spreading the purchase cost over time and, moreover, because the payments are fixed at the outset, it helps with budgeting.

The other main attraction of leasing is that almost all leasing companies will let you change your equipment part way through the agreed period instead of waiting until the lease expires. Your leasing company will terminate your old lease and issue you with a new one incorporating your new and existing equipment.

Most leasing companies will let you include ancillary costs like software, peripherals, consumables, network installation, maintenance and even web design and ISP charges.



According to leasing specialist Syscap, lease finance is now recognised as an efficient and rational option for funding computer hardware, software and related support services. It provides a flexible and cheap way of keeping pace with technology and can allow you to acquire the IT infrastructure you need when you need it.



Computer Resale offers IT kit and can also help finance the deal

Tony Field of leasing company ECS pointed out that, as well as financial considerations, there is the practical problem of disposing of your IT equipment when you've finished with it. You can't just throw it on the skip or even give it away without complying with expensive EC regulations and the Data Protection Act.

Finding the money

Almost all suppliers of business equipment will also be able to offer finance. There are, however, some fundamental differences in how they go about this. In most cases, the vendor makes arrangements with a finance house and if you want to buy from that vendor, you only have that single choice of financing.

Some single-source suppliers will make their own finance arrangements. evesham.com, for example, uses Evesham Finance, which offers lease purchase and lease rental. Unlike many, who will only deal with businesses that can show two years' accounts, Evesham includes start-ups (with extra security by way of guarantees from main shareholder directors). Customers can upgrade part way through when, subject to a satisfactory record, guarantees may be waived. Managing director Wayne Fowkes said sole traders may have better opportunities with Evesham Finance too.

Dan Technology doesn't ask for security, but does carry out a credit check. Dan's financial director, Peter Hobday, pointed out that banks will probably not finance services because they can't recover those costs in the event of a default and probably won't lend on installations either, without a second charge on directors' homes. Dan's finance service is provided by Syscap.

Elonex provides finance (from Sales Finance & Leasing) to established businesses (sole traders, partnerships, limited companies and PLCs) that have been trading for a minimum of three years. It also covers software, training, cabling, installation, implementation and maintenance. In addition, you can, at various points during the term of the contract, use a predetermined 'exchange allowance' to upgrade your system. If the lease runs its full term, you may either continue to rent the system for a nominal amount (typically the equivalent of one month's rental per annum) or sell it to a third party and share in the sale proceeds. There's a lease payment calculator on the Elonex website (www.elonex.co.uk).

Other vendors take a more flexible approach. For example, collaborative agreements with various leasing specialists, mean retailer MPC can try to offer tailored leasing to accommodate tax advantages, obsolescence, rapidly deteriorating assets and emerging technologies.

You are not limited to buying brand new equipment, however; refurbished machine specialist Computer Resale, with a nationwide network of stores, sells warranted second-hand machines and offers financing too.

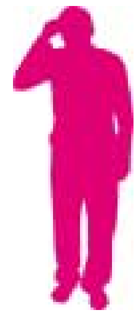
However, if you want to purchase equipment and services from several different sources, you can deal directly with the finance house of your choice and make your own arrangements.

One of the better-known finance companies providing a specialist IT-oriented facility is Syscap, which offers business finance terms ranging from one week to five years. As well as providing finance to many retailers, Syscap will also offer finance directly to small businesses. Syscap's web pages offer a near-instant leasing quotation (www.syscap.com).

If you need IT to get online, look at Barclays Bank's new Computer Leasing deal, which includes Internet access through Barclays.net. Small businesses can lease a choice of three PCs from the Compaq Prosignia range at £25 ex VAT per month, plus additional equipment and a pre-installed copy of Windows 98 with Word/Office 2000 (Small Business Edition).

Pros and cons of leasing

Pros	*Cons*
The lessor, in retaining ownership of the asset, has more security than other lenders, and may be able to offer more competitive financing rates.	There may be some restrictions of use, and you'll usually be required to obtain the lessor's approval for your insurance arrangements.
A lease is a medium-term facility that cannot be withdrawn or curtailed by credit difficulties or changes in economic circumstances, unlike facilities such as overdrafts, which are repayable on demand.	If you are a new company starting up you may find it difficult to obtain leasing terms.
The finance rate is usually fixed throughout the term of the lease.	You will not be entitled to any proceeds of the disposal of the asset after the end of its useful life. For some assets this may be significant.
Leasing can offer flexibility in repayments. Some lessors may adjust repayments to match seasonal variations in cashflow.	You cannot claim a capital allowance for ownership of the equipment; the leasing company claims the allowance.
Leasing will usually finance the whole cost of IT (except building work).	Leased assets cannot be used as security for borrowing purposes.



During the 36-month lease, customers can upgrade at any time (with the lease being recalculated) and lease, or buy additional equipment such as printers and scanners.

Taxing times

Whether you buy your capital items outright or pay for them over a fixed length of time, the Inland Revenue will let you set the costs against your tax bill. Most capital items qualify but there are exceptions, notably vehicles. Leasing can offer a tax advantage over purchase because a leasing contract comes to an end, whereas ownership does not. At the time of writing, if you own an item, you are allowed to offset 25 per cent of its current 'tax written down' value against your tax bill every year. In the first year its current tax written down value is the price you paid for it. In the second year, it is the price paid, less the 25 per cent already claimed BUT you can only offset 25 per cent of that lower sum. However long this goes on, you will never offset all of the original price.

In the case of leasing or renting, the instalments, which include capital and interest, are counted as legitimate business expenses and you can offset all instalments paid in a given financial year against that year's tax. So at the end of the lease you will have been able to offset the entire cost of the item against your tax bill.

However, the Government is about to change the balance between purchase and lease for some businesses. For the next three years, between 1 April 2000 and 31 March 2003, the Treasury is proposing to allow small businesses to offset all their 'information and communication technology' in the year of its purchase, but only if it is bought outright.

In addition to computers, this includes peripherals, cabling providing a data connection between computers, or between a computer and a data network (such as an external link to the Internet), dedicated electrical systems for computers, WAP (wireless application protocol) and third-generation (3G) mobile phones, Internet-enabled set-top boxes, bar-code scanners and electronic point of sale systems. It also covers software for all the above.

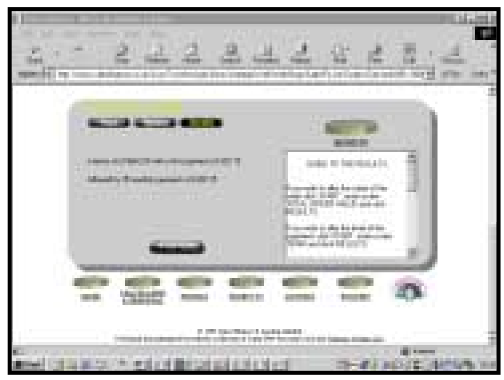
However, equipment acquired for leasing does not qualify for 100 per cent first-year allowances.

The Government has defined a small business as one with not more than £2.8m turnover, assets of not more than £1.4m and no more than 50 employees. If a company is a member of a group, the group must also be small when the expenditure is incurred.

If your business is within the definition of the Act and you have the money available, it would make sense to buy within the qualifying period of these regulations. If you don't have the money to buy outright, you're reliant on leasing with its built-in three or four-year allowance recovery period. Naturally, this has not excited lessors. Craig Pickering, head of asset finance at the FLA (Finance & Leasing Association) said: 'The FLA would like a tax system which allows SMEs to decide how to finance their IT investments. The Inland Revenue should collect the proceeds, not seek to influence SMEs' business decisions.'

The CBI, Engineering Employers' Federation, Chambers of Commerce, Machine Tools Technologies Association and the FLA all called for leasing to be included in the SME capital allowances package. But don't hold your breath for a change to the proposals.

Take advice



You can even get quotes online from Sales Finance & Leasing

The Government's increase in first-year allowances for IT equipment is good news for small businesses, even though many will not have the cash to take advantage of it. Beware, though, that the Inland Revenue advises individual companies to consult their local Inspector of Taxes on the exact detail of the equipment on which the allowances are being sought.

In considering any form of finance, remember that you will be paying more than if you bought outright and it's best to check all figures with an accountant before committing to any offer. In particular, don't let your choice be driven by perceived tax advantages.

Where to get finance

Financed deals

Computer Resale	0800 731 8143	www.compresale.com
Elonex	020 8452 4444	www.elonex.co.uk
evesham.com	0800 0353 353	www.evesham.com/index.asp
Dan Technology	020 8830 1100	www.dan.co.uk/
IBM	08457 414 314	www.ibm.com/businesscentre/uk
MPC	01923 249 898	www.mpcnet.co.uk

Independent finance

Barclays Bank	0800 49 49 49	www.business.barclays.net
ECS	0208 940 2199	www.ecs-group.co.uk
Lloyds TSB	020 7626 1500	www.lloydstsb.co.uk
Lombard	01737 774111	www.lombard.co.uk
Sales Finance & Leasing	01628 829123	www.salesfinance.co.uk
Syscap	020 8254 1800	www.syscap.com

Tax advice

KPMG	0161 246 4268	www.kpmg.co.uk/
Pannell Kerr Forster	020 7831 7393	www.pkf.co.uk

Further reading

Business MoneyFacts	by subscription £78.50pa	01603 476100
Lloyds TSB		
Small Business Guide	Penguin £12	ISBN 0-14-027721-8
Which?		
Way to Save Tax	Which? Books £14.99	ISBN 0-85202-635-8