

To Buy or Lease?
Does Uncertain Economy Give Rise to New Considerations?

By Lloyd W.W. Bell III

Leasing as a strategic method of capital financing has experienced rapid growth in the United States over the past 40 years. With it came increasingly complex implications regarding financing options, such as taxes, accounting methods, cash flow and risk of obsolescence.

Now, companies considering a capital purchase also must contend with the uncertain economy as a significant factor.

As the economic slowdown became categorized a recession, virtually every sector has felt the squeeze on cash flow. Companies of all types and sizes have less cash in their coffers, and banks and large financing companies have tightened their lending policies.

Many companies have recognized a continuing need to invest in long-term growth needs, particularly as technology has continued to march forward with newer, faster, more efficient methods and as competition has continued to intensify.

But companies also have been forced to take a hard look at their return on assets and reprioritize their capital purchase requirements. They have been buying less, according to industry estimates, but they haven't stopped acquiring all together. They've turned to leasing as a means of bridging the gap.

There are no clear-cut, right-or-wrong answers when faced with a decision about whether to lease or buy a piece of equipment. It takes a careful cash-flow analysis looking at upfront costs, financing costs, depreciation, maintenance, taxes and potential technological advancements to determine which option is best.

However, in the more recent economic downturn, companies increasingly have found leasing to be the better choice. Faced with declining revenues, companies have seen leasing as more attractive because it requires less cash upfront and it insulates them from any risk of obsolescence.

Leasing usually makes the most sense when there is a high risk that equipment will become obsolete before its useful life is expired or when the equipment will be needed for only a short period of time. Leasing may be desirable when capital must be preserved, when interest spreads are high, when depreciation in value is rapid, or when the tax benefits that can come with ownership are irrelevant.

As the economy soured, it was easy for many companies to meet many or all of these conditions to make leasing a logical choice. But now some economic indicators and experts are saying the economy has already hit bottom and we're starting to take baby steps toward a renewed sense of prosperity. If they're right, it means consumers will start spending again, and that's good for everyone in business.

At best, the economy's future direction seems less certain. That forces companies to exercise even more conjecture. What if our cash flow improves? What if interest rates start to climb? What if our tax status changes? What if we find later that want to keep this piece of equipment longer than two or three years? What if the piece of equipment we need could retain its value or perhaps even appreciate as the economy improves?

These uncertainties make the decision of whether to lease or buy no easier. However, the bottom line remains. It begins with a careful analysis of the company's strategy, priorities, and long-term goals. It includes a cash-flow projection associated with the many costs of capital and the associated tax implications.

With those actions, most companies can usually arrive at a sound decision regarding whether to buy or lease, despite any changes in economic condition that may be on the horizon.

At minimum, any uncertainty about the economy shouldn't prevent a company from acting on its capital equipment needs. Nothing can be accomplished while management holds a "wait-and-see" approach. By the time management "sees" the best course, the company may have lost valuable ground in its target market or its industry as competitors have stepped up and met market demands.

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