

SAP Financing –
An innovative financing approach to enable a
"pay-as-you-use" business model

Foreword

This white paper is intended to give background information about state-of-the-art financing options for IT solutions and to introduce the SAP Financing service. PricewaterhouseCoopers was mandated by SAP to assist in the development of SAP Financing, to assist in the selection of a global financial services partner, and to write this white paper.

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Executive Summary

Would you consider purchasing a tool that increases the productivity of your business processes when the monthly cost savings exceed the monthly payments from day one and when you don't need to make an up-front payment? If your answer is yes, then you should take a closer look at the SAP Financing service when you consider acquiring or extending your enterprise application software with SAP technology.

This white paper provides background information about state-of-the-art financing options for IT solutions and introduces SAP Financing, an innovative service that was developed by SAP with support from PricewaterhouseCoopers (PwC) and that is operated by Siemens Financial Services (SFS).

SAP Financing is a truly market-leading service. It is tailored to meet a customer's specific cash flow requirements to cover the software, hardware, implementation service, and maintenance costs for SAP solutions. Most important, the SAP Financing service recognizes the resource constraints faced by businesses of all sizes, allowing more flexibility while mitigating risk.

SAP Financing enables a pay-as-you-use financing model as an alternative to the traditional up-front payment scheme. It is a vendor-financing service in which the credit risk is spread across a global customer base. The corresponding global credit portfolio is diversified by country, industry, customer rating category, financing term, sales channel, and customer size.

The features of SAP Financing can be summarized as follows:

- Addresses the key financing issues of large, midsize, and small enterprises,
- All-inclusive coverage of project costs, including internal company project costs,
- Up to a seven-year term (including installation period),
- Global credit portfolio with a broad rating category spread and risk-based pricing,
- Generally no requirement for any up-front payment,
- Little or no impact on a company's credit lines,
- Operated by Siemens Financial Services, a respected and experienced global financial services company,
- Competitive service levels (for example, rapid credit approvals),
- Global coverage with local support,
- Monthly cost savings that exceed monthly payments from the very first day.

PricewaterhouseCoopers strongly believes that SAP Financing will enable companies to improve their business processes in an affordable way.

Commentary: SAP Gives ROI Strategies a New Role

Hans Juergen Uhin, Senior Vice President of New Business Development, SAP AG



SAP has introduced a radical paradigm shift in the way enterprises look at IT projects in the future: SAP Financing, which is operated by Siemens Financial Services. Over the past 10 to 15 years, many enterprises have realized the advantages that integrated business software can bring to their productivity. In particular, small and midsize enterprises (SMEs) have historically placed their bets on their own software and best-of-breed solutions. At first glance, these solutions seem to have a lower price because of the reduced cost of the initial purchase. Now, the trend is changing. Even SMEs have recognized the benefits of an integrated, long-term approach. But the financing challenge still remains. Due to a difficult financial environment and restrictive financial guidelines like Basel II, it is harder for companies to raise capital for investments.

Typically, IT costs have been seen as a long-term investment and ROI arguments have played an essential role in the sometimes difficult or protracted approval process.

With SAP Financing, those days are over. The model is simple. Companies can meet the costs for an SAP solution in easy-to-manage and predictable monthly payments. Most important, there are no hidden surcharges or unexpected surprises. The monthly fee covers all project-related costs, such as software, hardware, and services. It can even cover internal costs, where applicable.

Overall the investment in SAP software can be viewed as a productivity tool with a fixed monthly fee translated per user, comparable with other regular expenses or personnel-related costs.

SAP Financing has some other radically new features. Payments for the financing arrangement may start only after the installation is deemed productive – and not before. ROI has never been so tangible for companies. They obtain the expected results as fast as possible, and these results can be offset against the monthly costs. It's this price transparency that helps companies achieve precise planning. To a large degree, this is because SAP – unlike its competition – can predict costs exactly over periods of up to seven years. As a result, SAP can pass on many advantages to businesses, which need to plan ahead with confidence and without the danger of unexpected changes in their IT infrastructure and spending.

What makes SAP Financing especially remarkable is the speed and ease with which a financing offer can be processed. Assisted by an innovative calculation tool, the SAP investment calculator, SAP advisors can quickly determine the costs per person for a desired SAP solution and the number of users. After entering essential company and project data, SAP, and its global financing partner Siemens Financial Services can then evaluate, calculate, and decide the customer's IT project within competitive short time frames. Naturally, all customer data is 100% confidential.

Financing an SAP solution with SAP Financing means fully transparent, secure, and predictable monthly payments that include all related costs. No surprises or surcharges at any time – guaranteed. And no barriers preventing companies from choosing SAP.

Introduction

A large number of companies are still using enterprise application software that are built from old legacy software components and some best-of-breed software components, typically from different software vendors. These components need to be updated whenever a regulatory, legal, or tax change occurs. Therefore, companies are dependent on the release strategies of each of the individual software vendors. Whenever a vendor releases a new version of its software, this version needs to be interfaced, integrated, tested, and validated with all other software. Eventually, data needs to be migrated from the old version as well. Therefore, the update and upgrade process tends to cause excessive costs that are difficult to predict. The maintenance costs of heterogeneous systems grow exponentially with the number of different software components compared to a well-integrated, homogeneous software system from a single software vendor.

Furthermore, the average **useful** life of such heterogeneous enterprise applications software is, in most cases, less than seven years because:

- Some of today's best-of-breed enterprise applications components will no longer be best-of-breed by tomorrow,
- The maintenance of some software components might have been discontinued and therefore would become prohibitively expensive to keep them up-to-date with regard to regulatory, legal, or tax changes, for example, value-added taxes (VAT),
- Some software components might become obsolete because their vendors no longer exist, either because the vendor is acquired or goes out of business.

It is obvious that such an IT strategy can neither be cost-efficient nor enable a company to maintain or to enhance its competitive edge with increasing business process productivity and the ability to rapidly react to changing business needs.

Companies are increasingly vigilant with their business investments, so financing becomes a key issue when a company is considering adopting a new, well-integrated, homogeneous software system. Although nearly 40 percent of all global software deals with midsize enterprises are already financed, financing is becoming increasingly difficult to secure. This situation does not allow companies to implement state-of-the-art enterprise application software that would ensure and enhance their long-term competitiveness. In addition, conventional financing providers do not address the challenges of internal costs, which represent the largest single cost factor and which prevent many potential customers from making investments in IT.

To assist large, small, and midsize enterprises in acquiring homogeneous, well-integrated enterprise application software or in extending their current SAP-based IT solution, SAP has developed an innovative financing service called SAP Financing. It is tangible proof of SAP's desire to continuously innovate its offerings to address the demands of the market and its customers. SAP Financing addresses these issues by combining all relevant costs into a quantifiable monthly payment. This financing offer simplifies the budgeting process and helps customers more accurately predict the total cost of ownership (TCO) and return on investment (ROI) over the entire lifetime of their software solution. The SAP Financing service is based on the pay-as-you-use financing model, which is an attractive alternative to the traditional cash up-front payment scheme.

Total Cost of Ownership

Would you consider building a home without knowing up front how much it would cost you to do so? Or without knowing what your annual maintenance or operation costs would be? Probably not. The same is true for an IT system when the enterprise application software license fee is approximately 10 percent of the TCO. Understanding TCO is even more important when you consider financing your IT system.

The TCO model is a holistic cost structure view that encompasses the total life cycle of an IT system. TCO is defined as the sum of implementation costs and operation costs.

Implementation costs include:

- Software costs,
- Hardware costs (platform, technical infrastructure, and so on,)
- External service costs (software customization, implementation, training, and so on),
- Internal service costs (costs that are born at the company like training, extra hours of IT staff, and so on).

Operational costs include:

- Software maintenance costs,
- Hardware maintenance costs,
- Support costs (like the IT help desk).

It is important to understand that the enterprise application software costs represent only a small fraction of the TCO.

The TCO model can be best explained with a case study of a typical project. From this case study we will expand to explain the pay-as-you-use financing model and introduce SAP Financing and related concepts.

Please note that the TCO of enterprise application software varies from case to case because the software can be customized to support company-specific business processes.

The Case Study

Let's assume that a company wants to replace its current enterprise application software. The company is based in Germany and considers investing in a mySAP All-in-One IT solution. The implementation time for the new IT system is one year, and the company wants to use this IT system for six years. Table 1 summarizes the project's key characteristics.

Project Profile	
Company name	Mustermann GmbH
Number of professional users	50
Intended period of use	6 years
Implementation time	1 year
Main implementation country	Germany
SAP solution	mySAP All-in-One
Software costs	€160,000

Table 1: Case Study: Project Profile

Based on our industry expertise, we estimate that the implementation costs can be split up as described in Table 2.

Software costs	22% of implementation costs
Hardware costs	16% of implementation costs
External service costs	27% of implementation costs
Internal service costs	35% of implementation costs
Total	100%

Table 2: Average Implementation Costs Split Up

On the basis of €160,000 software costs, the total project implementation costs of the project equal €727,273. Table 3 shows the split.

Software costs	€160,000
Hardware costs	€116,364
External service costs	€196,364
Internal service costs	€254,545
Total	€727,273

Table 3: Case Study: Implementation Costs Split Up

In terms of software maintenance costs, SAP uses the 5-1-2 maintenance rule, which means that during the years one to five following the introduction of the software, the annual SAP software maintenance costs will be on average 17 percent of the software costs. This figure rises in year six to around 19 percent and again in year seven to 21 percent of the software costs in case the customer does not migrate to the next software release.

However, most customers update their software within twelve months following its release, a practice that is also assumed in our case study. Therefore, no incremental maintenance costs are born due to the 5-1-2 maintenance rule, and the software maintenance fee remains 17 percent of the software costs from year one to seven.

We estimate the average yearly operations cost to range from 14 percent to 25 percent of the initial implementation costs for IT enterprise systems. Assuming operations costs of 25 percent and combining this figure with the assumptions described above, the SAP-specific operations costs can be further split up, as shown in Table 4.

Software maintenance costs	15% of operations costs
Hardware maintenance costs	20% of operations costs
Support costs	65% of operations costs
Total	100%

Table 4: Average Operation Costs Split Up

Using the data from Table 4 the split up of the TCO over six years (plus one year of implementation) can then be assessed as shown in Table 5.

Implementation costs	39%
Operation costs	61%
Total	100%

Table 5: Case Study: Average SAP TCO Split Over Six Years (Plus One Year implementation)

In our example, which is based on €160,000 software costs, the average TCO split into implementation and operation costs for six years (plus one year of software maintenance during implementation) are as shown in Table 6.

Implementation costs (first year)	€727,273
Operation costs for six years	€1,118,109
TCO over seven years	€1,845,382

Table 6: Case Study: Average SAP Implementation and Operation Costs

In summary, in this specific case, the implementation costs for a mySAP All-in-One project would amount to €727,273 and split up as follows:

- 22 percent software costs or €160,000,
- 16 percent hardware costs or €116,364,
- 27 percent external service costs or €196,364,
- 35 percent internal service costs or €254,545.

Year	1	2-7
Software maintenance costs	€27,200	€27,200
Hardware maintenance costs	-	€37,187
Support costs		€117,432
Total costs	€27,200	€181,818

Table 7: Case Study: Average SAP Operation Costs Split Up

The operation costs in the second year are around 25 percent of the initial implementation costs for a total of €182,000. The calculated operation costs split up as follows:

- 15 percent software maintenance costs or €27,200
- 20 percent hardware maintenance costs or €37,187
- 65 percent support costs for company staff and outsourced services or €117,432

Figure 1 shows the TCO structure of this project.

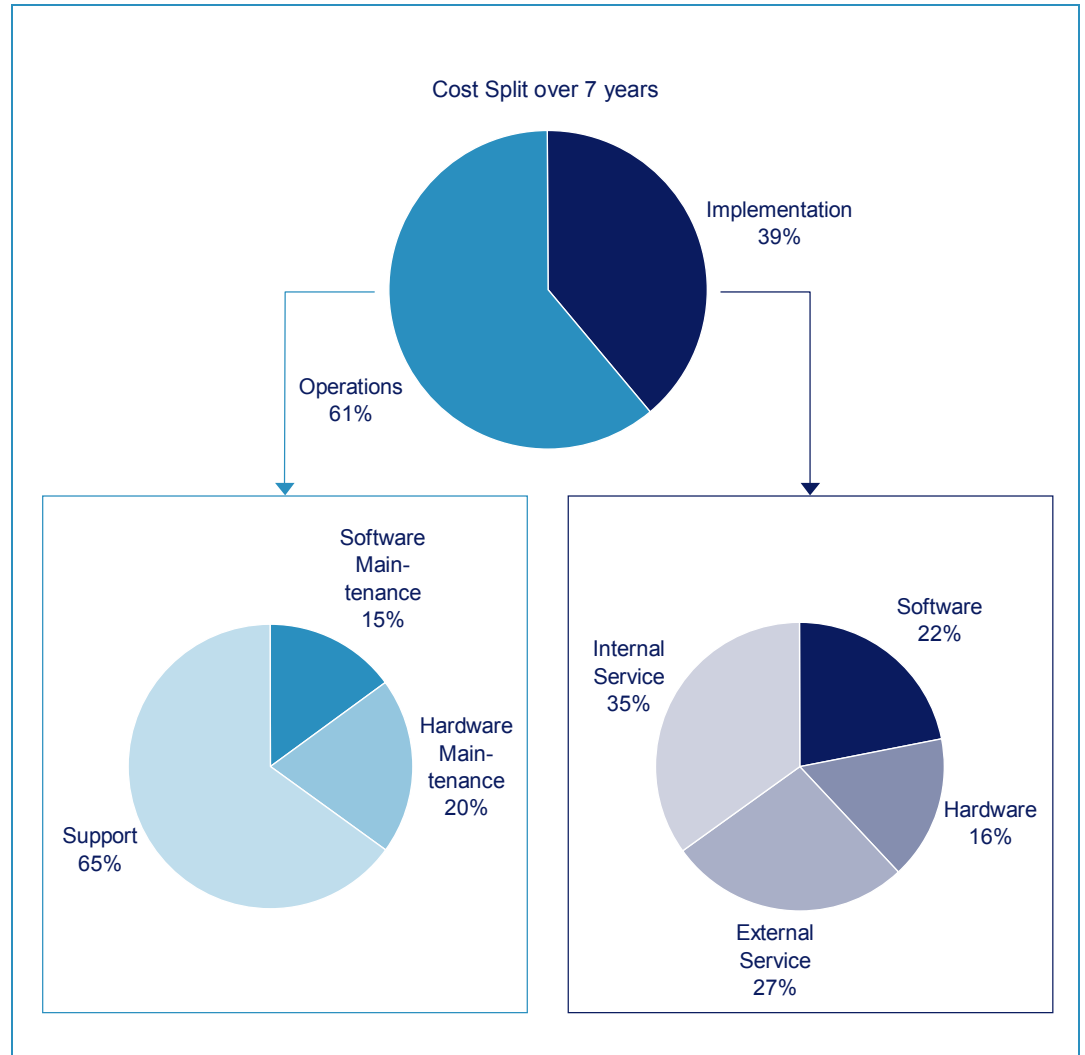


Figure 1 Case Study: Total Cost Split Over Six Years (Plus One Year Implementation)

Conclusion

There is an important lesson to be learned from this example: looking at the price of just the enterprise applications software component can be very misleading because it represents less than ten percent of the predictable TCO, especially if the useful life of the IT system is assumed to be seven years. However, the useful life of the IT system can be, according to SAP, as long as 12 years, which further reduces the software price as a percentage of TCO. Even more important than the price of the enterprise application software is the risk that the software vendor will be able to update and to maintain the software over the useful life of the IT system.

Pay-As-You-Use Financing Model

Business processes supported by enterprise application software require fewer resources to produce a specific output and are thus more efficient. Fewer resources translate into a lower cost for a given business process. These cost savings, which are born by implementing enterprise application software, can be called the benefits of enterprise application software. If the total benefits are larger than the TCO, then the company has **positive** net cost savings:

$$\text{Total Net Cost Savings} = \text{Total Benefits} - \text{TCO}$$

Enterprise application software is designed to increase productivity in nearly all business processes. In business functions like accounting, the introduction of finance software may lead to the reduction of days needed for closing the books because information is more reliable and accessible more quickly. The integrated nature of the system eliminates multiple, redundant data sources. This implies that the costs of closing the accounts are also reduced – in other words, the process is more efficient.

Nevertheless, an enterprise needs to surmount the following barriers before it can take advantages of enterprise application software technology:

- The perceived large up-front investment,
- The perceived long payback period.

If the annual benefits (which can be considered as a virtual cash-in) exceed the annual cost of ownership during the entire useful life of the IT system, these main barriers no longer exist. In other words, there would no longer be an economic reason why companies shouldn't immediately take advantage of enterprise application software. We'll demonstrate this key benefit of the pay-as-you-use financing model using our previous case study.

One way to enable net cost savings starting from the first day is to debt finance the IT software. Debt financing means that the investment payments are distributed over a financing period, which can equal the lifetime of the investment asset. In this case, we can talk of a pay-as-you-use financing model because payments have to be made at the same time the investment asset generates profits. Unfortunately, not all companies want or can obtain debt financing. SAP Financing might remove this barrier by using a global credit portfolio approach, a concept that we will explain later in this document.

Debt-Financing Products

The financial services sector has developed a set of debt-financing products to address the specific needs of their potential customers. It is important to understand that debt-financing products very much depend on country-specific regulations:

- Tax,
- Accounting standards, such as US Generally Accepted Accounting Principles (US GAAP), International Financial Reporting Standards (IFRS), and the German Commercial Code (Handelsgesetzbuch or HGB),
- Legal, which is especially important for software licensing.

Consequently, any company interested in debt financing should seek advice from its local tax, accounting, and legal advisor. Therefore, this white paper – which is written for a global audience – cannot give specific advice on “the” optimal financing product within a specific country. Instead, it provides an overview of generic financial products, which are appropriate for the debt financing of IT software.

Table 8 shows the generic debt-financing products that are appropriate to implement in the pay-as-you-use financing model.

Type	Description
Loan	Good operating history, credit rating, and debt ratios are the keys. The customer receives immediate ownership of the asset. The repayment of the loan is agreed upon at the outset and is usually made over an agreed upon period on a monthly or quarterly basis with a fixed interest rate.
Hire purchase	The customer (the hirer) selects a product, and the lender pays the supplier for the asset. The lender keeps the title of the asset until the last payment is done. Ownership of the asset is transferred to the hirer when the hirer exercises the purchase option at the end of the term by making a final payment. This product typically has lower credit requirements than a loan.
Finance lease	Finance leases extend over the economic life of the leased equipment. The lessee pays the full cost of the equipment, plus interest, over the primary term of the lease agreement. Finance leases cannot be cancelled. The lease payments are fixed, unconditional payment obligations equivalent to debt service. This product typically has lower credit requirements than a loan.
Operating lease	The ownership of the asset stays with the lender, who receives full control over it after the lease term has expired. As a result, the lessee has to pay lower rental payments, and the risk of the asset stays with the lender. The credit requirements are typically lower than a loan.

Table 8: Generic Debt-Financing Products

The different characteristics of these generic debt-financing products give a company the option to choose the financing product that best fit its specific business situation. These products include special financing products like sale and lease back.

Debt financing by specialized financial institutions usually translates into lower interest rates.

Global empirical studies suggest that the main reason why companies use specialized debt financing is to lower the transaction costs of financing. Transaction costs increase because of the information gap between the financing party and the company. They arise because the financing party is not experienced in financing IT software and therefore applies a higher risk premium.

Another factor that increases the risk premium is the typically high up-front investment for an IT system. This cost has a negative impact on liquidity and therefore raises the probability of a loan default. In a regular loan transaction, for instance, the success of the deal for the financier depends mainly on the ability of the company to pay back the loan. If the company defaults, the financier makes a financial loss that depends on the utilization of the company's assets after a default. The higher the probability of default and the higher the loss given default, the higher the financial loss for the financier. Higher risks of default raise the risk costs, which are passed on to the customer.

The advantages of generic debt-financing products can be individual and vary for every company and country. As already stated above, they mainly depend on a country's tax, accounting, and legal system, as well as on the financial situation of the company. (Please consult your tax, accounting, and legal advisor about the specific implications for your company.) It is important to note that for each of the generic debt-financing products, the customer has to enter an unconditional payment obligation, and the performance risk is with the customer or the vendors and suppliers of the products and services on which the IT system is based.

Purchase Versus the Pay-As-You-Use Model

If a company decides to acquire an IT system with a traditional purchase, then the first year is characterized by significant up-front payments due to the implementation cost and operation costs until the IT system goes live. In other words, the system creates costs before it produces benefits.

PricewaterhouseCoopers estimates that three out of four inhibitors of applications software investments in 2004 were of financial nature:

- High or prohibitive costs for software, implementation, and integration,
- Slow economy and reduced profits,
- Unwillingness to assign or grow the IT budget,
- Uncertainty or difficulty calculating ROI.

Let's elaborate on the case study presented in the previous chapter. Let's assume that a company would like to understand its costs for an intended ownership of seven years. Table 9 shows the calculated TCO of the case study split up over the usage and implementation time.

Year	1	2-7
Implementation costs	€727,273	0
Operation costs	€27,200	€181,818
Total costs	€754,473	€181,818

Table 9: Case Study: TCO Split Up Over Seven Years

Traditional Purchase

In the first year during the implementation time, the costs of ownership of the SAP solution would be €754,473 due to implementation costs of €727,273 and one year of software maintenance costs during implementation of €27,200. In the second year – after the system is in productive use – operational costs amount to €181,818.

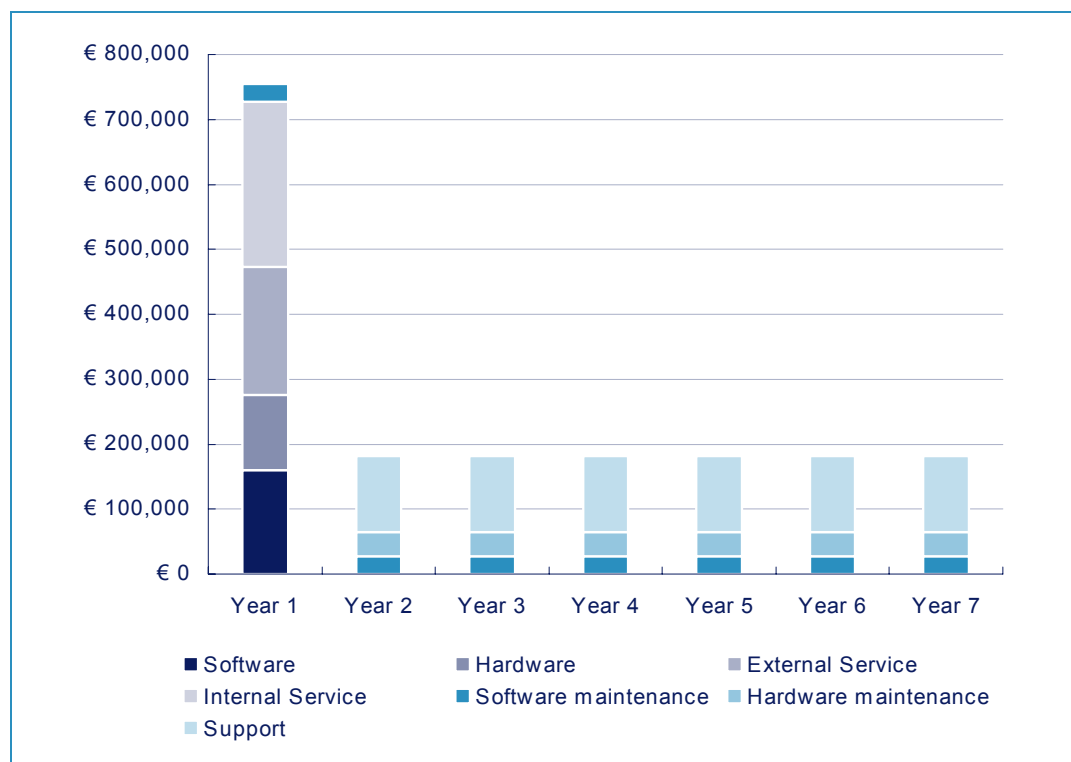


Figure 2: Case Study: Annual Cost of Ownership for Traditional Purchase

Debt Financing

For the sake of the argument, let's assume that this year's available IT budget of the company is just €500,000 and cannot be increased. It would be therefore an insurmountable barrier for a traditional purchase.

Debt-financing models can be designed so that companies start their repayments only after the IT infrastructure has been implemented and goes live. In other words, repayment only starts after the benefits are materializing and are already offsetting the costs of ownership.

Let's further assume that the company wants to finance the implementation (including the SAP software maintenance costs during the implementation period). Let's assume an interest rate of 5.5 percent (based on current German capital market conditions) and that the software and hardware are delivered at the beginning of the implementation project, that external and internal services are paid monthly, and that the software maintenance is paid quarterly. Providing that the company would like a fixed monthly repayment only starting after the system went live, Table 10 shows the financed amount, including costs of financing.

Total Financed Amount	Implementation Costs	Desired Finance	Implementation Costs including Costs of Financing	Costs of Financing
Software	€160,000	100%	€197,946	€37,946
Hardware	€116,364	100%	€143,961	€27,597
External service	€196,364	100%	€236,926	€40,562
Internal service	€254,545	100%	€307,126	€52,581
Software maintenance	€ 27,200	1 year	€32,669	€5,469
Total	€754,473		€918,628	€164,155
Fixed monthly repayment	€12,759			

Table 10: Case Study: Total Financed Amount

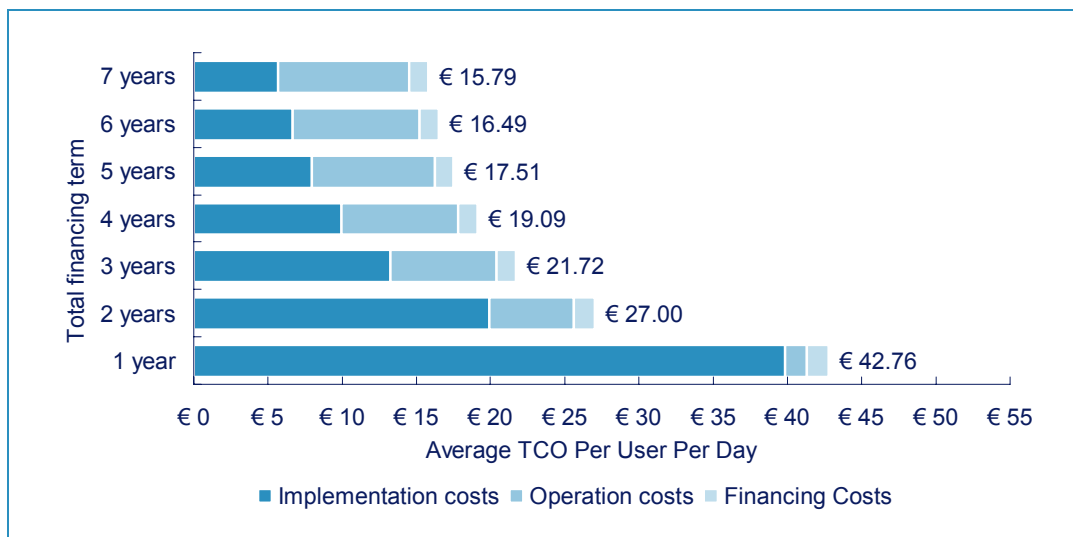


Figure 3: Case Study: Average TCO Per User Per Day in Relation to Total Financing Term

Figure 3 illustrates that the financing costs represent only a small fraction of the TCO. The TCO per user per day decreases to €16 if the total finance period increases. Some readers of this white paper probably have cell phone costs that are higher than €16 per day.

Specifically, assuming an interest rate of 5.5 percent and a tenor of seven years (one year installation and six years operation), the total cost of financing is €164,155.

The Pay-As-You-Use Financing Model

So far, we have only considered the costs. To determine the total net cost savings, we also have to estimate the total benefits according to the formula total net cost savings = total benefits – TCO.

Unfortunately, the benefits of an IT system are difficult to measure and to quantify. The benefit of an IT system is actually the cost savings that stem from the productivity improvement of the business processes that are supported by that IT system. Based on industry experience, we estimate that the company can achieve average annual benefits that equal 36.35 percent of the TCO (over seven years) of €1,845,382 as depicted in Table 6. This implies that the annual benefits in our case study are €670,865.

If the company had purchased the IT system traditionally, the total net cost saving is the cumulative difference between the annual benefits of €670,865 and the annual costs of ownerships (as shown in Figure 2).

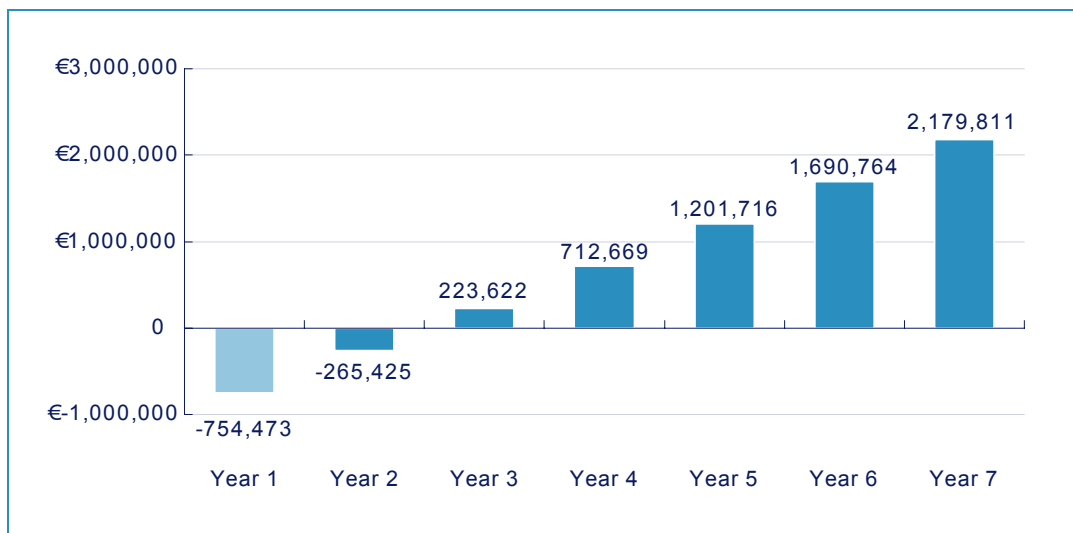


Figure 4: Case Study: Cumulated Net Cost Savings for Traditional Purchase

If the company used debt financing, such as the pay-as-you-use financing model, it would have to start making payments only after the system had gone live.

What are the benefits that the SAP-based IT system should materialize so that the SAP solution will be paid back with the last installment of the debt repayment after seven years (or six years after the IT system went live)? The average payback amount per year should be €334,923 or 18.15 percent of the TCO.

Assuming again average annual benefits equivalent to 36 percent of TCO, the pay-as-you-use financing model yields a positive annual net cost savings from the very first day of repayment because the annual costs of ownership (including the costs of financing) are lower than the annual benefits of an SAP solution. The cumulated annual net cost saving in the financing model is then the cumulative difference between the annual benefits of €670,865 and the annual costs of ownership (including financing costs) as shown in Figure 5.

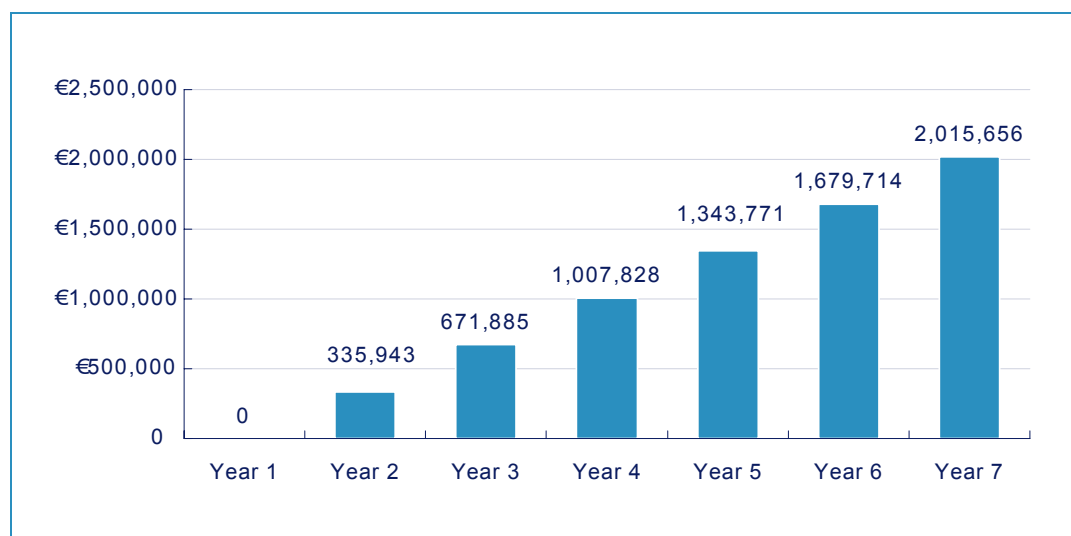


Figure 5: Case Study: Cumulated Net Cost Savings with SAP Financing

The comparison suggests that:

- The cumulated annual net cost savings for the pay-as-you-use payment scheme is higher than that of the traditional purchase solution up to the fifth year,
- The total net cost savings for the pay-as-you-use payment scheme is €2,179,811 – €2,015,656 = €164,155 higher than that of the up-front cash payment solution.

This example demonstrates the attractiveness of SAP Financing and the pay-as-you-use financing model with regard to debt management.

The pay-as-you-use financing model provides two advantages. First, it typically yields a positive net cost saving from the very first day. Second, it has limited impact on companies' credit lines. These two key advantages make SAP Financing attractive for most companies.

Prerequisites for Pay-As-You-Use Financing

Debt financing in our context is financing through the issuance of debt by a financial institution. Leasing of company cars or other material assets are typical examples of debt financing. Debt financing of other material assets is a well-established business practice; debt financing of all-inclusive IT systems – which are composed of both material and immaterial assets (like SAP software, services or other non-asset backed items) – is not.

The financier's decision to grant debt financing depends mainly on a company's ability (expressed as a credit rating) to pay back its debt. Table 9 depicts Standard & Poor's (S&P) credit-rating criteria.

	S&P Rating Category	Brief Description
Investment grade	AAA	An obligation rated AAA has the highest rating assigned by S&P. The obligor's capacity to meet its financial commitment on the obligation is extremely strong.
	AA	An obligation rated AA differs from the highest-rated obligations only by a small degree. The obligor's capacity to meet its financial commitment on the obligation is very strong.
	A	An obligation rated A is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations of higher-rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still strong.
	BBB	An obligation rated BBB exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.
Non-investment grade	BB, B, CCC, CC, and C	Obligations rated BB, B, CCC, CC, and C have significant speculative characteristics. BB indicates the least degree of speculation and C the highest. Such obligations will likely have some quality and protective characteristics, but they may be outweighed by large uncertainties or major exposure to adverse conditions.
	D	An obligation rated D is in payment default.

Table 9: Standard and Poor's Rating Category

Under Basel II, access to debt capital is becoming increasingly difficult and expensive for non-rated companies like most SMEs. In economic downturns, traditional lenders tend to tighten their credit lines and to be more restrictive about providing additional capital. This scenario is becoming even more common due to the effect of Basel II.

With access to capital being one of the main drivers of competitiveness for a company, debt financing is an appropriate financing for investments that enhance the competitiveness of the company, especially in the pay-as-you-use financing model where the company's net cash flow is typically positive.

Advantages of the Pay-As-You-Use Financing Model

The pay-as-you-use financing model is based on a statistical portfolio approach to spread the credit risk over a large population, for example, across a global customer base. The corresponding credit portfolio is diversified by country, industry, customer rating category, financing term, sales channel, customer size, and so on. Table 10 lists the advantages of the pay-as-you-use financing model.

Advantages	Description
Limited up-front payment	Debt-financing solutions do not require up-front payments like regular purchases, which addresses budget constraints.
Access to capital	Debt financing can be an access to capital.
Net cost saving positive	Payments are closely mapped to benefits, so the investment project typically remains net cost saving positive in every year.
Preservation of credit line	Debt financing has little or no impact on current credit lines.
Pay as you use	The investment is financed through the incoming benefits it generates.
Budget forecast	A fixed payment plan gives budget planning security over the coming years.
Key financial figures (balance sheet optimization)	Key figures like ROI and profitability can be improved by managing the balance sheet.
Flexible contracts	Flexibility in the design of debt-financing contracts guarantees an adjustment to the company's needs and strategic targets.
Reduced risk of new investment	The risk of the new investment can be reduced by using debt financing incorporating options to return the asset to the lessor.

Table 10: Advantages of the Pay-As-You-Use Financing Model

SAP Financing

With 12 million users, 88,700 installations with 26,150 customers, SAP is the world's largest enterprise software company and the world's third-largest independent software supplier overall. SAP has a rich history of innovation that has made SAP a true industry leader. Today, SAP employs more than 32,000 people in more than 65 countries.

PricewaterhouseCoopers assisted SAP in developing a vendor-financing service that not only offers financing (lending, leasing, and so on) of the purchase of SAP software and certain initial SAP maintenance services, but also services provided by SAP service partners and system resellers, including customer external and internal implementation services, customer internal implementation services, and certain hardware and possibly third-party software applications. SAP Financing is based on the pay-as-you-use financing model.

SAP Financing is operated by Siemens Financial Services (SFS), a global business and technology-focused financing company with 1,700 employees. SFS currently manages over €10 billion in assets, and its international network gives it the ability to offer financial support for companies in 30 countries worldwide.

Commentary: PricewaterhouseCoopers assists SAP in developing the world's most advanced global software vendor financing service

Dr. Dr. Werner Trattnig, Director Advisory, PricewaterhouseCoopers AG WPG

With the advent of new business models in the software industry like subscription models (for example, salesforce.com) or pay-as-you-go financing models that help to accelerate ROI by reducing up-front project and infrastructure costs, the software industry needs to respond to this new customer demand. Market



research suggests that approximately 75% of the inhibitors to enterprise application software investments are of a financial nature. An obvious solution to this crucial customer problem is to offer a financing service that translates up-front capital investments into pay-as-you-earn or pay-as-you-use operating expenses, similar to the familiar model of the mobile phone business. Unfortunately, this straight-forward solution creates a business challenge for the software vendor because it is keen to recognize revenues immediately – as soon as the sale of a software license is completed rather than deferring revenues into future periods. This requirement is paramount for SAP to meet the capital market's growth expectations. The cause of the business challenge is that according

to US GAAP rules – which apply to any corporation listed on a US stock exchange – SAP can only recognize software revenues immediately if the license fee is fixed or determinable (among other criteria). Because any involvement of SAP in financing bears a financial risk for the supplier, the license fee cannot be considered as fixed, and therefore SAP has to defer software license sales until actual payments are due. It is fair to expect that also IFRS will require companies to apply similar accounting rules, which means that companies that are not even listed on a US stock exchange would be affected in the near future. The solution to this problem is to strictly separate financial risk from performance risk (for example that SAP software performs as specified).

The business model developed by SAP with advice from PwC assigns the financial risk to an independent third party and the performance risk to SAP. This solution enables SAP to recognize revenues immediately. PwC advised a global approach so that the credit risk could be spread over the largest possible population; the credit portfolio is diversified by country, industry, customer rating category, financing term, sales channel, and customer size. In particular, the financial risk is addressed by a portfolio approach rather than by pledging assets. Consequently, all costs associated with building and operating an IT system (the TCO) can potentially be financed – even the internal implementation or training costs of a customer.

This approach offers companies maximum financing flexibility (for example, off-balance sheet) without stretching their credit lines under Basel II. As far as the sales process is concerned, SAP is focusing on selling its software- and service-oriented architecture solutions, and it involves a global financing partner whenever a customer is interested in financing. PricewaterhouseCoopers has been mandated by SAP to assist in the development and implementation of a global vendor-financing service by supporting SAP in developing a structure that is compatible with US GAAP – while minimizing any material risk – and by organizing a tender process and selecting a vendor-financing service partner.

For this purpose PricewaterhouseCoopers has prepared the required information documents (Project Brief, Information Memorandum), held meetings with various global financial institutions, evaluated the respective proposals, and short listed four candidates. Taking into account all hard and soft selection criteria, PricewaterhouseCoopers advised SAP to select Siemens Financial Services as its preferred vendor-

financing service partner. Among all candidates, SFS offered:

- The best global coverage (both in the initially covered 13 countries, including emerging countries like China, India, Russia, Poland, Brazil, Mexico, and the following rollout to a total of 40 countries)
- Solid corporate brand and refinancing through Siemens AG
- Extensive experience in vendor financing
- Full support of a global risk portfolio approach
- Minimized local currency issues
- Rapid credit decisions (for example, for Australia in 2 hours up to 2 working days for €2,000 up to €1 million)
- The best rating category spread (10% of portfolio for B+ and B) and best tenor (up to seven years)
- Competitive pricing

PricewaterhouseCoopers supported SAP in negotiating the global contract, in minimizing any foreseeable risk, and in optimizing the SAP Financing offering and associated tools and processes.

PricewaterhouseCoopers strongly believes that this innovative, multi-billion-euro financing service will globally give enterprises rapid access to the most advanced software and business process technology and will enable SAP to further expand its market leadership and SFS to enhance its strong global vendor financing position.

PricewaterhouseCoopers advised SAP in choosing the ideal financing services partner. For this purpose PricewaterhouseCoopers has prepared the required documents (project brief, information memorandum), and evaluated the respective proposals from various global financial institutions.

SAP Financing offers four different debt-financing solutions:

- Loan,
- Hire purchase,
- Finance lease,
- Operating lease.

In each of the offered SAP Financing products, the customer enters an unconditional payment obligation, and the performance risk (the risk that the delivered product or service performs as committed by the supplier) is with the suppliers or the customer itself (if it is involved in the implementation of the IT system).

The different characteristics of the SAP Financing products give companies the option to choose the financing product that best fits their specific business situation. Depending on local practices, these options include special financing products like sale and lease back.

The advantages of the debt-financing products can be individual for each company and may vary for each country. As already stated, they mainly depend on a country's tax, accounting, and legal system, as well as on the financial situation of the company. (Please consult your tax, accounting, and legal advisor about the specific implications for your company.)

In October 2005, SFS launched SAP Financing in 13 countries (the Phase I countries). By July 2006, SFS will expand the service to 28 additional countries, serving a total of about 40 countries. SAP's goal is to grow SAP Financing as soon as possible after its inception in most countries where SAP is active.

Phase I Countries	Phase II Countries	
Australia	Austria	Slovenia
Brazil	Belgium	Sweden
China	Czech Republic	Switzerland
France	Denmark	Turkey
Germany	Estonia	Canada
India	Finland	Chile
Italy	Greece	Hong Kong
Mexico	Hungary	Japan
Poland	Ireland	Korea
Russia	Luxembourg	New Zealand
Spain	Netherlands	Philippines
United Kingdom	Norway	Singapore
United States	Portugal	Taiwan
	Slovakia	South Africa

Table 11: Countries Where SAP Financing Will Be Available

Sales Processes

SAP Financing covers services provided directly by SAP, as well as those provided by third parties. To be covered under SAP Financing, installation services must be performed by members of SAP's partner network. SAP partners are subject to various quality and financing approvals to assure the highest possible quality standard for SAP Financing.

The sales process is supported by a Web-based sales tool called the investment calculator. The investment calculator's rules and knowledge base, combined with the extensive knowledge of an SAP account executive (or an SAP partner's account executive), help companies estimate the future TCO structure.

Commentary: Tailor-made financing packages facilitate technology investments. This opens up opportunities for companies to diversify their funding base.

Dr. Herbert Lohneiß, CEO Siemens Financial Services GmbH

An increasing number of enterprises are up against a dilemma in their businesses because of difficulties in obtaining financing. Banks are unquestionably reducing their exposure to corporate credit risk by cutting down their portfolio of relationship-lending clients. Commercial banks are doing more than just keeping interest rates high; they are also lending smaller amounts for shorter periods, demanding more collateral, and imposing stricter covenants.



However, businesses in Europe and around the world have to obtain their liquidity from somewhere. It is becoming increasingly difficult – especially for SMEs – to obtain loans or other financing from their banks. Yet they still need to invest, especially in IT and other technologies.

According to a recent survey of Siemens Financial Services, the majority of companies will suffer from inadequate investment in technology, and they will fail to sustain their competitive advantage. IT investments are core to helping businesses around the globe catch up with the competition.

But how can they afford investments without the necessary financing? How do they keep up with the latest technology without losing too much liquidity? Companies ought to consider alternative, smart financing tools for IT and other technology investments. Given their high share of debt financing, companies are finding it increasingly important to draw on alternative means of financing to make technology investments – in particular because many have delayed IT investments since the start of the new millennium. Most companies made their last major investments in technology in 1999.

In light of this difficult situation, investments in IT and other technologies are more necessary than ever to help companies support their business. Small and midsize enterprises are still financing a large share of their IT and telecommunications investments from internal funds. This highlights that investments in these areas are driven less by related competitive advantages or technological use than by the short-term availability of funds.

So, in most cases, equipment is not upgraded when it makes best sense from a technological point of view, but when liquidity becomes available. This opportunistic, reactive approach creates financing problems for SMEs and deprives businesses from cutting-edge technologies that enable them to compete in global markets. Businesses discovering advantages of new and smart ways of financing are better able to outsell their products and beat the competition.

Companies interested in the pay-as-you-use financing model transmit a request for SAP Financing to SFS. SFS contacts the company and requests credit-specific information if necessary. SFS verifies if the terms of the financing request are within the agreed-upon ranges of the SAP Financing service, and if necessary, adjusts some terms. At the same time, SFS conducts a risk assessment. SFS is committed to responding in an agreed-upon timeframe, which is competitive with respect to local business practices. If the financing requirement is below a certain amount, an automated credit check is performed. The following two examples give an indication of service levels.

United Kingdom

Amount	Tool/Contact	Response Time
€1,000 to €500,000	Internet ease-lease	1min to 1 working day
€500,000 to €5 million	SFS representative	1 to 3 working days

Table 12: Response Time in the United Kingdom

Australia

Amount	Tool/Contact	Response Time
€2,000 to €1 million	Internet and help desk	2hours to 2 working days
€1 million to €3 million	SFS representative	2 to 3 working days

Table 13: Response Time in Australia

After a company has secured financing from SFS, it orders the software license and the associated software maintenance services from SAP. The ordering process depends on the sales channel through which the company is served.

It is important for customers that services like implementation, customization, training, and consulting services are provided by suppliers that meet SAP's stringent quality standards. Therefore, a company should select a qualified and approved SAP service partner as its supplier. To minimize the implementation performance risk, SAP Financing only finances implementation services provided by SAP business partners.

After implementation suppliers have been selected and the corresponding products (like hardware) and services (like customization service) have been ordered, the new IT system is implemented. As soon as certain delivery milestones have been met, a supplier sends an invoice, depending on the financing product selected, to the company (in case of a loan) or to SFS (in case of a lease). If the company accepts the delivery, it sends a certificate of acceptance to SFS, and SFS pays the supplier.

Note that the performance risk (warranty) always lies with the supplier and that the financial risk (for example, the default of the company) always lies with SFS. SFS can bear this financial risk because it is distributed over a diversified global credit portfolio.

Another innovative component in SAP Financing is that SFS also finances the companies' internal efforts of the implementation (for example, training, extra hours, and so on) up to a certain multiple of the price of the SAP software products. If appropriate, a company could utilize periods of lesser business activity to maximize its human resources to implement the IT system, and this investment would be financed by the financier as part of the all-inclusive project costs.

In the pay-as-you-use financing model upon which SAP Financing is based, a company does not have to start its monthly payments **before** the IT system is deemed productive. In other words, the company has already gained the benefits – business process cost savings – when it begins making monthly payments. Therefore, this model typically generates a **positive** net cash flow.

In our opinion, the features and benefits of SAP Financing can be summarized as follows:

- Addresses key financing issues of large, midsize, and small enterprises,
- All-inclusive coverage of project costs, including company internal project costs,
- Up to a seven-year term (including the installation period),
- Global credit portfolio with broad rating category spread,
- Generally no requirement for any up-front payment,
- Little or no impact on a company's credit lines,
- Operated by Siemens Financial Services, a respected and experienced global financial services company,
- Competitive service levels (for example, rapid credit approval response time),
- Global coverage with local support,
- Typically generates net cost savings from the very first day.

Conclusion

SAP Financing is an innovative service that was developed by SAP with advice from PricewaterhouseCoopers and is operated by Siemens Financial Services. It makes state-of-the-art SAP technology affordable to enterprises of all sizes. It is ideally suited to address the special needs of midsize enterprises.

SAP Financing Is All-Inclusive

One key advantage of SAP Financing is that it finances all TCO components. Another innovative element of SAP Financing is that it also finances companies' internal efforts for implementation (such as training, extra hours, and so on) up to a multiple of the price of the SAP software products. This approach enables companies to utilize periods of lesser business activity (when personnel are underutilized) to improve the productivity of its business processes. The company not only better utilizes its human resources, but it also receives cash from SFS for those internal services that are necessary to implement the IT system.

SAP Financing Is Predictable

SAP Financing is predictable because a company has full transparency over its fixed monthly payment stream from the first day of operation during the entire useful life of its SAP solution. Furthermore, SAP Financing can be extended along with the SAP solution.

SAP Financing Is Affordable

Another great advantage of SAP Financing is the pay-as-you-use financing model; a company can choose to start payments for its SAP solution when it starts to produce benefits that exceed its costs and typically generates a positive net cash flow from the first day of payment until the end of its useful life.

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