National Funding

Small Business White Paper

Small Business Equipment Procurement: Is It Better to Lease or to Purchase?

Equipment is one of the most fundamental needs for small business owners. Without it, day-to-day operations would suffer from the lack of infrastructure, customers would not be serviced to their expectations, and competitors would be able to pull ahead. The fact is, every small business needs equipment, but not every owner knows how to go about procuring such basic tools, hardware, and software.

When pondering how to get a hold of equipment, small business owners often run into a dilemma that has confounded many: Is it better to purchase said equipment outright, or investigate alternative financing options like leasing? Owners give serious consideration to the type of equipment they plan to obtain, and as such, should give equal thought to the fiscal route they will take to get it.

Both purchasing and leasing have their own set of pros and cons - so how is a small business owner supposed to choose? In the end, it may all boil down to the circumstances. But even then, there are clear advantages to each method that owners need to be aware of.

The Case for Purchasing

Purchasing Leads to Outright Ownership

The clearest advantage small business owners have in purchasing is that they own their equipment outright and on the spot. There is no fretting over monthly payments - once an owner commits the cash, he or she assumes full ownership of the equipment.

This is especially advantageous for owners purchasing items that have an extended longevity of usefulness, a criterion that refers to the time span in which a given piece of equipment continually proves itself to be useful in daily operations without incurring major costs from repairs just to keep it from falling apart. Securing equipment with a longer life of usefulness through purchasing may prove to be a more reasonable option, if, for instance, owners are in the market to obtain desks made of metal or wood - which have a useful life of 15 years, according to an equipment lifespan of usefulness database kept by the University of Maryland [1].

Similar equipment that has a long life of usefulness and is not in likely danger of becoming obsolete include: safes and vaults (40 years of usefulness), conference tables (22 years), miscellaneous office furniture (15 years), file cabinets (12 years) and dental chairs (12 years).

Once an owner purchases a piece of small business equipment, that item will immediately become an asset to the organization. The equipment is on the books and in the records, and instead of being a liability of sorts - because an owner would still have to make monthly payments under leasing terms and conditions - the equipment is fully purchased and completely owned by the business [2].

Up-front Costs Can Constrict Maneuverability

While equipment purchasing pays off immediately in the form of full ownership and a documentable asset to the firm, small business owners might have to first pay a lot to even sniff those advantages. Purchasing involves dedicating cash up front, and in some cases, what is requested in initial cash commitments may prove too large of an expense for small business owners to take on at one singular point in time. If owners pursue a loan to finance their purchase, they should also be aware such avenues of financing often require a down payment, which can be as high as 20 percent or more [3].

Expensive equipment purchases can cause a rash of problems for small business owners if they put up too much money initially. One such serious consequence is the tendency for large equipment purchases to constrict cash flow. The more money an owner has to delegate to purchasing, the less he or she has to work with for the rest of the month - or a longer period of time after the initial purchase. Such a large commitment can put an unnecessary strain on working capital and considerably restrict an owner's maneuverability to manage his or her business - especially if some clients are past due on payments or sales have been slow for the month.

Full Ownership Means Equipment Responsibilities

Complete and total ownership of equipment is often a source of pride for small business owners. After purchasing a piece of equipment, owners become the rightful owner and can enjoy all benefits it brings. However, they must also assume full responsibility for equipment, and that can become a major issue for owners and hold a business back.

When an operator owns equipment, he or she may not only be the sole owner, but the only one with an equipment-related obligation. As such, when a newer, better, and faster piece of equipment comes out, owners are stuck with the model they have because, under purchasing terms, they cannot trade in equipment if it becomes obsolete.

This is especially applicable to technology equipment purchases. While software has a useful life of 10 years, other key equipment pieces like computers and servers (both four years) are becoming less and less useful over the long term. Scientific and engineering advances in the modern era have spurred a previously unseen technology equipment boom. The rapid pace at which technology moves means that sooner or later, full ownership will become a disadvantage to owners because they will be stuck with a piece of outdated equipment they are solely responsible for. In that case, the only action owners can take is to donate, recycle, or sell the equipment [4].

One need only look at the proliferation of mobile devices for an example of how fast equipment can become obsolete. Apple released its first generation of the iPad in 2010. Fast-forward three years to 2013 and the tech giant is already up to its fourth generation of the iPad; it also released a completely different offering called the iPad mini in that time span.

Yet another responsibility of outright ownership that small business owners must be aware of is the associated costs of regular maintenance and repair work they will be liable for. While some owners may not think twice about such expenses, repairs and maintenance costs can become a slippery slope. There's a fine line between productive repairs that extend longevity of usefulness and procrastinating repairs that only suck cash from the owners while barely keeping equipment alive [5[.

In either case, owners are responsible for the costs. Now, such a scenario might not sound so bad for an owner that purchased a desk that needs a little bit of refurbishing. But for the restaurant owner that bought a refrigerator (eight years of useful life) that needs constant maintenance just to keep food cold, the costs and responsibilities of repairs may be a burden large enough to make equipment purchasing a less-than-optimal decision.

The Case for Leasing

Lower Monthly Payments

When small business owners opt to lease equipment, they pay monthly installments that go toward paying off the equipment in full. One of the most attractive aspects of this kind of financing route is the low short-term cost owners incur when they lease equipment. Depending on the type of lease they can secure, the monthly payments owners make under the leasing conditions might allow them to spend less per month than they would have if they had purchased the equipment.

Flexibility is a huge draw for leasing, and lower monthly payments, made possible through a financing option such as this, can markedly help small business owners manage their finances and their business while not worrying if an upfront purchase might tighten the purse strings too much.

Keeps Owners Up To Date

While purchasing technology equipment often bogs owners down with the responsibility of outdated and obsolete equipment, leasing does just the opposite. Leasing enables owners to keep current with the latest trends in small business technology equipment because after an owner pays off a piece of equipment, he or she can return that item in exchange for a newer and better model [6].

Say an owner has a two-year lease on a server, but during that time, the business also grew enough to necessitate a more powerful server. If an owner purchased a less-powerful server, he or she would then have to find a new server to fit the company’s needs and buy it. But if at the end of a two-year lease, owners find themselves in such a position, once the lease expires, they are free to procure upgraded pieces of equipment without the added anxiety purchasing causes.

Tax Incentives Are a Major Factor

If owners decide to use leasing in order to buy equipment, they also can get some added help from the government. Under the Section 179 deduction, small business owners can deduct up to $500,000 from their taxes on equipment purchases totaling no more than $2 million [6]. The limit was enhanced under the provisions of the deal that avoided the fiscal cliff scenario and will be in effect for the rest of the year. However, the deduction is expected to be drastically reduced in 2014.

As such, many owners will turn to leasing in 2013 in order to deduct as much as they can on equipment purchases they might have put off. It's also a tremendous resource for small business owners because the deduction applies to a range of equipment purchases, including: equipment for business use, tangible personal property used in business, business vehicles that weigh more than 6,000 pounds, office furniture, and office equipment. Leasing and applying for the Section 179 deduction also goes a long way in helping owners avoid equipment irrelevancy, because they can deduct purchases involving computers and off-the-shelf software.

The various pros and cons of purchasing and leasing small business equipment have been laid out, but in the end, it often depends on what the owner needs and has available to pay for it. If an owner is looking to buy a freezer for the office kitchen, it might make more sense to purchase the item outright. However, if an owner wants to obtain a truck or trailer to be used for business purposes or more capable server technology, leasing could provide a much more beneficial and cost-saving route of procurement. In regard to the latter, National Funding offers a slate of affordable and practical leasing and financing options to help small business owners get the equipment they need to succeed.

Sources:

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