



# SMBs and Large Enterprises Value Financing Solutions from Microsoft

Small & Medium Business Strategies

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## Executive Summary

Tight budgets, understaffed IT departments and outmoded software and hardware are harsh realities for many corporations.

Cash-constrained businesses no longer must defer much-needed Microsoft software upgrades or the hardware and services purchases that typically occur during a migration. The solution: Finance software purchases for a 2-, 3-, 4- or even 5-year period via Microsoft Financing, a wholly owned subsidiary of Microsoft Corp.

Microsoft Financing's Total Solution Financing provides partners and end-user corporations with flexible, economical and easy-to-use financing options to make necessary purchases and upgrades and abrogate the need to have cash up front to fund much-needed purchases. It enables businesses to manage their finances more flexibly and preserve precious cash for focused core business initiatives or special projects.

This is not the first time Microsoft has offered customer financing. The firm's first foray into financing began in 2002 as part of an incentive plan for the smaller Open Value customers. But that financing plan was funded through an outside bank and not Microsoft itself.

Hardware leasing programs have been available for a long time through server and networking vendors such as IBM Global Financing and Cisco Capital because hardware equipment has a short life and customers prefer to lease hardware. Software-focused financing programs have only recently become popular and provide long-term benefits to both small and large enterprises. The lucrative SMB and mid-market enterprise segments have high interest in software financing solutions.

In a relatively short time, Microsoft Total Solution Financing has become a high-growth financing solutions provider in the software applications and solutions area for Microsoft customers in the United States (see Exhibit 1). Microsoft's program features competitive financial rates and is complemented by a

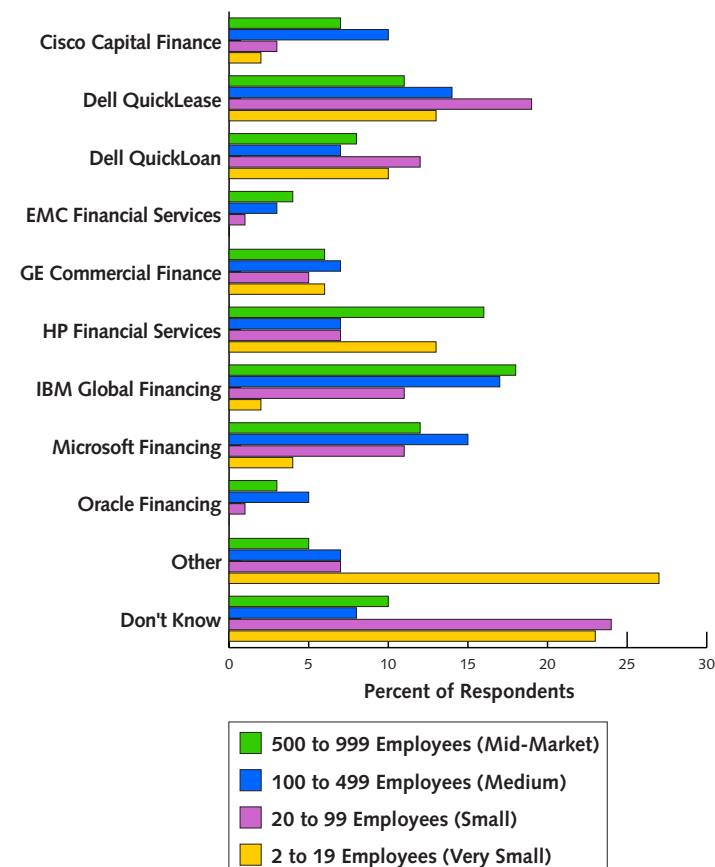
vast channel partner network. Microsoft Total Solution Financing has garnered significant market traction.

Yankee Group research indicates that nearly one-quarter of very small and small businesses don't know where they'd go for vendor financing. This represents a significant opportunity for Microsoft partners, customers and Microsoft itself.

### Exhibit 1

#### Market Interest in IT Solutions Financing and Leasing Vendors

Source: Yankee Group 2005 Small & Medium Business Applications and Web Survey



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## I. All Companies Can Benefit from Software Financing

As organizations take stock of their networks, they need every bit of leverage they can get to perform the necessary upgrades and get access to the appropriate aftermarket technical service and support in a timely manner. This is true of all businesses: from small and midsize firms with fewer than 100 users, to corporate accounts with 500 to 1,000 users, to the largest enterprises with tens of thousands or even hundreds of thousands of users spread across multiple remote locations.

Companies of all sizes in all verticals can benefit from financing. As the world's largest software manufacturer, it's not surprising that Microsoft has a big stake in every market size and segment. Everyone's definition of what constitutes a small, midsize (or corporate) or enterprise business varies somewhat. Microsoft defines a small business as one with 25 or fewer connected PCs; a midsize or corporate account is one that has between 25 and 500 PCs; and an enterprise is any organization with more than 500 PCs. There are various tiers within the corporate and enterprise companies.

According to Microsoft's own statistics, it has the following number of customers in each tier:

- **SMBs:** 40 million customers worldwide
- **Midsize corporate accounts:** 1.2 million customers worldwide
- **Enterprises:** 18,000 enterprise businesses worldwide

At first glance, it might appear that Microsoft Financing's (formerly known as Microsoft Capital Corporation) new financing initiatives would appeal primarily to the smaller SMB and mid-market corporations, which have smaller purchasing budgets and far fewer personnel resources in their limited IT departments for rollouts. Although there is financing that appeals to small and midsize businesses, large and very large enterprises with thousands or even tens of thousands of users spread out in multiple remote locations can derive just as many benefits by taking advantage of extended financing options as their smaller counterparts.

The most obvious advantage associated with a "buy now, pay later" financing program is the ability to keep up with the latest software and hardware platforms and the services associated with deployment, ongoing management and training. This enables businesses to keep their edge in extremely competitive market conditions.

Additionally, financing plans provide businesses with the flexibility to take capex funds that otherwise would have been devoted to equipment purchases and divert them to other business necessities, including:

- Increased R&D spending
- Sales expansion
- Facilities, plant and equipment expansion
- Hiring additional IT staff or software engineers
- Investing in training and recertification for network administrators

## II. Total Solution Financing from Microsoft Financing

**M**icrosoft Financing introduced its Total Solution Financing in the summer of 2005. It is designed to remove the “cash up front” burden associated with implementing and maintaining software, hardware and consulting services. This program enables enterprises to extend IT solutions costs over time so they can manage business finances more effectively today and preserve cash for focused growth opportunities.

Total Solution Financing covers the cost of a company’s entire business management system, including:

- All software from Microsoft that is part of the solution
- All Microsoft Business Solutions software and services
- Third-party software from authorized ISV partners, which is also part of the complete solution
- Hardware (servers, PCs, storage and network devices) required to get the solution up and running
- Reselling partners’ consulting, implementation and integration services
- Warranties and annual maintenance on the software and hardware components of the solution

In creating its Total Solution Financing program, Microsoft Financing responded to partners’ and customers’ requests to simplify the usually complex and confusing paperwork. It replaced the former nine-page contract with a two-page document.

Microsoft’s intent is to provide prospective partners and customers with “transparency,” said Brian Madison, general manager of Microsoft Financing. “We want customers to know what they’re going to pay up front when they use Microsoft Financing—no tricks, no hidden agendas and no nasty surprises after they sign the contract. It’s just simple straightforward terms and conditions in the contract,” Madison said.

The company also responded to the tougher economic climate and raised the percentage of credit approvals to more than 90% in North America. At present, Microsoft Financing is available in seven countries: the United States, Canada, Belgium Germany, the Netherlands, the United Kingdom and Spain. The goal is to offer Microsoft Financing solutions to 12 markets by June 2006 and 20 of the top worldwide markets by 2008, Madison said.

### To Finance or Not to Finance

**G**iven the immediate and tangible benefits of financing and extended payment plans, one might assume that corporate users are rushing to sign on the dotted line. But that’s not necessarily the case.

Microsoft Financing VAR partners extolled the virtues of the plan and customers generally like the idea.

“From a partner perspective this is great. I like having the option of offering it to my customers,” noted Mike Snyder, a co-owner of Sonoma Partners, a Microsoft customer relationship management (CRM) VAR in Chicago.

Snyder said that Microsoft has made its financing options simple and easy for him to sell. “Microsoft is a known brand, not a no-name bank. It’s available everywhere in the US. I don’t have to do any work,” he observed.

Snyder also appreciates the comprehensive nature of the Microsoft Financing plan. “It really is a total solution. Customers can finance far more than their software licenses. The fact that you can also get 3-, 4- and 5-year payment options for hardware and partner services is a real boon to end users,” Snyder said.

Snyder said the simplicity of the credit approval process should appeal to even the most cautious customer.

“It’s a two-page application and baseline credit check. This is not an onerous process. It’s a simple straightforward agreement. From our perspective we can leverage it to close a deal—especially when users have no more budgets,” Snyder said.

Michael Klein, president of Computer Directions, a consultancy based in Searingtown, N.Y., services the New York metropolitan area. The overwhelming majority of his clients are SMBs that would welcome Microsoft’s financing options as a means of keeping their competitive edge without overtaxing their annual IT capex budgets.

“Microsoft Financing is a terrific incentive plan, particularly in today’s market where every dollar counts,” Klein said.

Klein and Harry Brelsford, president of NetHealthMonitor, a systems integrator and consultant that specializes in SMB installations in Seattle, Wash., concurred that Microsoft Financing represents a potential boon for all parties: Microsoft, its VARs and corporate customers.

Two caveats remain: Microsoft must work more closely with its VARs to market Microsoft Financing and it must overcome some apprehension on the part of customers who are not accustomed to financing their software purchases.

A November 2005 Yankee Group web-based poll of 300 end users—more than 55% of which are SMB shops with 50 users or fewer—found that 20% are not aware that Microsoft Financing exists.

Brelsford was aware of some, but not all of the bundled particulars of Microsoft Total Solution Financing package. He said that the availability of Microsoft’s one-stop software/hardware/services financing package could prove a powerful lure that helps users overcome purchasing obstacles.

Brelsford thinks that financing options such as those offered by Microsoft Financing are the most obvious solution for customers that believe they have no money to pay for Windows Small Business Server 2003 and Brelsford’s services as an SMB consultant.

“Lease financing options have become a very popular option and a very hot discussion topic among my customers over the past 12 months,” Brelsford said. “The fact that Microsoft has expanded traditional financing to encompass the consultant’s time for deployment and ongoing administration should make this package very appealing,” he added.

According to Brelsford, Microsoft Financing offers “another arrow” in the SMB consultants’ quiver. “Microsoft Financing should prove extremely effective because it gives SMB and mid-market customers choices and options right now, when they need it,” Brelsford said.

### III. One-Stop Software Financing Simplifies Software Acquisition and Maintenance

**E**xtended financing plans have long been a staple of hardware and network infrastructure purchases. But they were atypical and rare in the software industry. Harsh economic realities are forcing changes. Data from the Yankee Group *2005 Small & Medium Business Applications and Web Survey* indicates that nearly two-thirds of businesses worldwide will increase their IT spending in 2006 and 2007. But the majority of the increases will be in the modest 5% to 15% range. This doesn’t leave much room for big purchases—particularly for those businesses interested in major software, hardware and services upgrades. For cash-constrained companies that lack the upfront capex funds, vendor financing programs such as Microsoft Financing’s Total Solution Financing offer immediate benefits including:

- Flexibility
- Improved cash flow
- The ability to install and utilize the latest software, hardware and concomitant services
- The advantage of dealing with a known entity (e.g., Microsoft Financing) rather than a no-name bank

All of the aforementioned benefits have the potential to help the vendor’s VAR partners and ultimately end-user businesses of all sizes across all vertical markets accelerate sales.

If the licensee chooses to take advantage of vendor financing, then it enters into a financing contract with the software company or with a captive finance company, usually in the form of an installment payment agreement (IPA). The software company and the licensee will usually use the IPA to finance both the upfront license fees and future maintenance and support. In typical transactions, 30% to 50% of the amounts financed under the IPA may relate to future maintenance and support services to be provided by the software company.

When developing budgets for IT investments, businesses need to consider not only hardware and software costs but also additional costs that they will incur on installation, training, upgrades, integration services and ongoing maintenance. They also need to evaluate both current and future needs, and choose solutions that can support business growth and advanced technology objectives.

With Microsoft Financing, SMBs can combine financing for hardware and services (maintenance and integration) on the same contract as the software, which simplifies the application process, makes it easier to budget and consolidates all associated payments on a single monthly invoice.

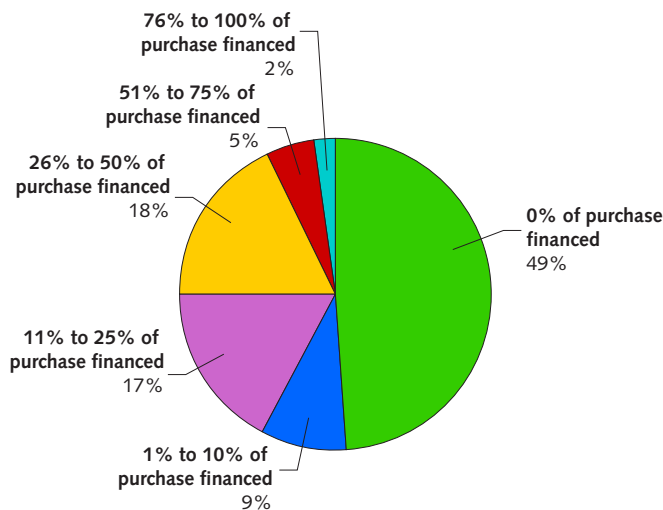
## IV. Market Analysis

To date, SMB and mid-market enterprises have not taken full advantage of the financing and leasing options available to them (see Exhibit 2). Fifty percent of this market segment does not finance any IT purchases. The Yankee Group 2005 *Small & Medium Business Applications and Web Survey* found that interest in financing increases in direct proportion to the growth of the individual company. However, businesses are still financing only a small percentage of their total IT purchases (see Exhibit 3).

About 50% to 60% of small companies and 25% to 35% of medium and mid-market enterprises do not finance or lease. Of the companies that have used these options, most are only financing/leasing 11% to 50% of the annual IT software and services purchases.

**Exhibit 2**  
SMBs and Mid-Market Enterprises Are Not Taking Advantage of Financing Programs

Source: Yankee Group 2005 *Small & Medium Business Applications and Web Survey*



**Exhibit 3**  
Businesses Are Only Financing a Small Percentage of Total IT Purchases

Source: Yankee Group 2005 *Small & Medium Business Applications and Web Survey*

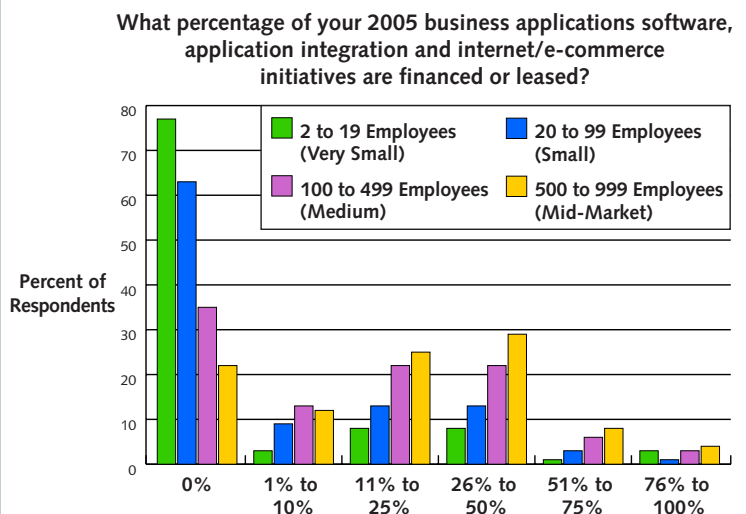


Exhibit 4 shows the importance of financing when SMBs are making their purchasing decisions. More than half of our survey respondents now view the availability of a financing option as important. This is likely to change in the future because vendor financing and leasing options have been available to this market segment only for a few years. As the market leaders in the SMB segment (e.g., IBM, Dell, Cisco, Microsoft, HP) promote their financing solutions aggressively to the market, SMBs are becoming more aware of the availability and benefits of vendor financing solutions. Most of these companies include a financing option in all of their proposals.

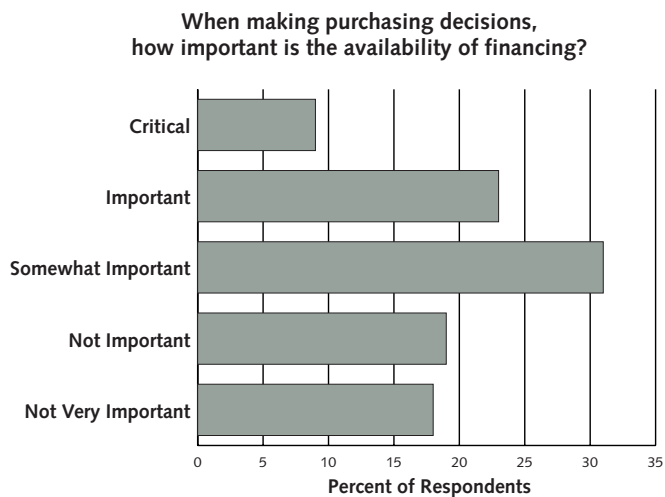
### Differences Between Financing and Leasing for Software Purchases

When purchasing software, SMBs’ payment options are paying cash, loans, leasing and financing. When determining which option to use, SMBs need to consider:

- The life of the asset
- Ownership concerns
- Tax treatments
- Collateral and financial guarantees
- Financial flexibility requirements

#### Exhibit 4 Financing Is Important to SMBs When Making Purchasing Decisions

Source: Yankee Group 2005 Small & Medium Business Applications and Web Survey



Traditionally, hardware has constituted the bulk of IT purchases. Financing instruments such as leasing became very popular primarily because the leased hardware assets have a fixed useful life after which they need to be replaced. This is not the case with software purchases. In most cases, smaller SMBs don’t understand the differences between financing and leasing—and the fact that they can finance/lease their software solutions and associated hardware, services and maintenance. Exhibit 5 shows some of the key differences between the two methods of financing.

#### Exhibit 5 Financing vs. Leasing

Source: Yankee Group, 2006

	Financing	Leasing
<b>Usage</b>	Financing is now being used for software solution acquisitions.	Leasing is traditionally used for hardware purchases, where the hardware asset is returned at the end of the lease.
<b>Life of Assets</b>	If annual maintenance is included with initial purchase, then customer gets all patches and upgrades.	Most hardware has a fixed 3- to 4- year life before the equipment becomes obsolete.
<b>Ownership</b>	Ownership resides with customer. Customer receives ownership/title to the assets at the time of purchase.	Ownership resides with lessor. If the customer is interested in buyback, the customer gets title transfer after meeting all of the contract obligations (payments, fees, late charges, etc.).
<b>Tax Treatment</b>	Customer owns the software/equipment and is eligible for the associated depreciation benefits.	For a tax lease (risk of ownership resides with the lessor not the customer), the lessee/customer can expense the payments for tax purposes.
<b>Collateral/Guarantees</b>	Financing transactions are done with the financed asset as the underlying collateral. As a form of credit enhancement, from time to time, finance companies may request a personal guarantee from the principal owners of the SMB.	Leasing transactions are conducted with the financed asset as the underlying collateral. As a form of credit enhancement, from time to time, finance/leasing companies may request a personal guarantee from the principal owners of the SMB.

## V. Why and How to Begin the Financing Process

A long-time supplier of financing solutions, IBM continues to lead in leasing solutions for hardware and solutions purchases. However, Microsoft Financing is the high-growth financing solutions provider in the software applications and solutions area for Microsoft customers in the US SMB market and mid-market (see Exhibit 1). The lucrative SMB and mid-market enterprise segments have high interest in software financing solutions. With competitive financing rates and a vast channel partner network, Microsoft Financing has quickly gained market traction in the small and medium segments where Microsoft is a household name. Almost one-quarter of the very small and small businesses don't know where they'd go for vendor financing—another opportunity for a company like Microsoft that is deeply entrenched in smaller businesses.

### Advantages of Financing

- **Manage high growth:** Increase businesses' purchasing power and ensure timely delivery of purchases. Expand the current available IT wallet.
- **Convenience:** Financing provides one-stop financing for a total solution. Hardware, software and maintenance can be included in the financing contract when businesses work with a vendor like Microsoft.
- **Flexibility:** Payments can be matched to budgetary levels. Businesses can manage situations such as cash flow, equipment needs, taxes and company growth rates more effectively and can help define the terms of financing.
- **Lower cost:** Financing conserves capital. Monthly financed payments may be less than monthly bank loan payments and no down payment is required. Also, 100% of the transaction including software, hardware and services can be financed.
- **Fast:** Customers get fast turnaround on financing decisions, within 48 hours in most cases.
- **Easy:** Financing with a vendor like Microsoft typically requires less documentation than bank financing.

- **Protection against obsolescence:** The financing can be structured to include software assurance, which provides the customer with upgrades and new product releases during the financing term.
- **Improve relationship with Microsoft:** When businesses pay for purchases within the terms of the Microsoft agreement, it helps them foster a stronger relationship with the Microsoft and fosters special treatment when working with Microsoft VARs.
- **Improved financial results:** Financing reduces the total cost of ownership (TCO).

### What to Look for in a Financing Partner

- **Financial strength:** Picking a strong, financially healthy vendor as a financing partner is key. As one of the largest software companies in the world, Microsoft Financing has the capability to negotiate and provide competitive rates.
- **Solution approach:** SMBs need financing partners that offer an entire solution. Microsoft Financing takes a solution-oriented approach to financing, where the solution includes hardware and software components and additional costs that SMBs will incur on installation, training, upgrades, integration services and ongoing maintenance. SMBs also need to evaluate both current and future needs, and choose solutions that can support business growth and advanced technology objectives.
- **Flexibility:** Vendors must offer various financing structures to solve SMBs' common problems. Microsoft Financing offers several types of financing structures and payment terms that can be tailored to meet the specific requirements of SMBs.
- **Technology focus and expertise:** Vendors that have a software technology focus can work with SMBs to provide expertise and support to develop and install the solution and make it operationally effective. In this case, the financing vendor has a deeper engagement than just being another financing option.

- **Response time:** Vendors should respond quickly to customers during the initial financing process as well as when customers have ongoing operational issues during the term of contract.
- **Terms and conditions:** SMBs should not need expensive legal counsel to review and execute financing agreements. Microsoft Financing has put in the upfront work required to simplify the financing documents and the review/approval process.
- **Worldwide scope:** Although the initial program focuses on a limited number of geographic regions, Microsoft Financing plans to roll out its program in several other countries.

## VI. Benefits for Microsoft Channel Partners

Microsoft Financing's Total Solution Financing provides significant benefits to Microsoft's channel partners. It presents an opportunity for them to get involved in the upfront strategic IT planning cycle and understand customers' short-term and long-term requirements for complete IT solutions. This helps the VARs gain an in-depth understanding of customers' vertical industry and gets the appropriate complementary VARs involved to help craft solutions that are flexible, scalable and extensible. In addition to this, it provides the following benefits:

- Shortened sales cycle
- Potentially increases sales revenue and profit margins
- The ability to recognize revenue up front
- Greater opportunities for up-selling and cross-selling
- Less pressure on discounting
- Competitive advantage on winning deals compared to other software suppliers
- Ability to improve cash flow and receivables outstanding; Microsoft Financing funds quickly

## VII. Recommendations

Software financing packages are a relatively new option for software purchases. Consequently, some companies may be reluctant to try this new option. Others may express cynicism.

Knowledge is power. Only after organizations thoroughly investigate and engage in frank discussions with their VARs and vendors will they realize the extent to which they can benefit from extended financing plans.

### Recommendations for Microsoft

To build awareness, Microsoft ran a special 0% financing solution promotional program for its US-based customers between 2004 and June 2005. Under the terms of the promotional program, users could finance any Microsoft product with a 0% interest rate over 36 months.

Sonoma Partners' Snyder noted, "You can't get much better than zero percent financing." But at its annual Worldwide Partner Conference in Minneapolis in July, Microsoft attempted to do just that by offering a 101% financing promotion for attendees. Any partner that attended the conference and submitted a customer transaction to Microsoft Financing after July 7 that commenced by September 30 received 101% of the amount financed. The end-user customer got 100% financing, while the VAR partner received an additional 1% incentive bonus to arrange the financing.

The company is now offering a financing program that provides the ability to offer deferred monthly payments and no interest during the initial 3-month period with Microsoft Financing. In addition to providing one financing source for all products and services needed to implement a technology solution, the deferred payment period can also help with managing budget constraints. The deferred payment promotion is for transactions signed between October 17, 2005 and March 31, 2006 that are greater than \$10,000 with terms between 24 and 60 months.

Microsoft should continue special promotions targeting SMB and mid-market organizations

It should follow up with widespread advertising promotions that are specific to the countries in which it currently offers financing: Belgium, Canada, Germany, the Netherlands, Spain, the United Kingdom and the United States.

### Recommendations for Partners

- **VARs that are not currently involved in Microsoft Financing should investigate the program.**
- **VARs should aggressively construct outreach programs** via e-mail, telephone and in-person briefings with their corporate clients to let them know that the program exists and inform them of the specifics.
- **VARs should contact their local Microsoft user groups and hold joint meetings** with them or speak at their meetings to publicize Total Solution Financing. In many instances, the local Microsoft office may be willing to donate office space for such events and provide refreshments or copies of a particular Microsoft software package to raffle off at the event.

### Recommendations for Customers

- **Evaluate Microsoft Financing now, while interest rates remain relatively low.** Enterprises that are considering new IT solutions should aggressively evaluate buying these solutions now. These plans should encompass current requirements and also anticipate the company's needs for at least the next 2 to 3 years, and perhaps as many as 5 years ahead.
- **Look for a financing partner that specializes in software financing.** All lenders are not created equal. Prospective corporate borrowers should evaluate lenders such as Microsoft Financing that specialize in software solutions financing. Software financing can be different from hardware financing because the warranties and annual maintenance plans are different. Also, there is no residual asset value as in the case of hardware leases.

- **Know your VAR and know your vendor suppliers.** Establish a relationship with your VAR and the appropriate sales and product managers within your vendor accounts. Get to know them and let them get to know you. This is beneficial for all parties. Set up a schedule of monthly or quarterly teleconferences or in-person meetings. Businesses that institute ongoing dialogue with their VARs and vendors will get the best deals. By doing so, your business as well as its current and future technology and financing needs will remain firmly fixed in your suppliers' minds. This makes it more likely that they will take the initiative and contact you when there are special promotions such as the 0% financing program Microsoft offered in early 2005.
- **Shop and compare.** Knowledge is power. Discuss financing options early in the purchase cycle. Ask your VARs to provide your company with specific, detailed information on financing solutions from the key vendors of the solution.
- **Review the financing contracts.** Study the terms and conditions of the various financing contracts closely. Don't be intimidated if you find the language confusing or nebulous. Ask your corporate attorney to review the contract. If your organization does not retain internal corporate counsel, consult with an outside law firm that specializes in contract negotiation and financing. Make a detailed list of questions, write them out and bring them to your meetings with VARs or the appropriate Microsoft or vendor salesperson. Don't be afraid to ask your VAR or salesperson to amend the terms and conditions of the contract to make them align more closely with your organization's business goals. In some cases, the VAR or lending vendor may adjust the contract.
- **Carefully review the financing rates and approval cycle time frames.** In most cases, the VAR may be able to get some level of preliminary pre-approvals from the vendor financing program office. This will give you a better idea of what you can afford and the related monthly payments.
- **Finance wisely.** Actively seek out financing companies that can deliver a total turnkey solution that encompasses the entire software and hardware technology, aftermarket service and support, deployment and installation resources, and ongoing maintenance. Ensure that all of these services are spelled out in detail in the contract.

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