GETTING ON THE RIGHT SIDE OF THE CAPEX VS. OPEX DIVIDE

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If you're like most CIOs, you're being asked to do more with less. Support more applications, more websites and more devices for more people… with less budget than last year.

BUT HOW?

This white paper can help, by:

- Explaining why CIOs must think more like CFOs
- Showing the difference between capital expenses and operating expenses
- Suggesting an area where you can clearly do more with less.

THINK LIKE A CFO

"The CFO is increasingly becoming the top technology investment decision-maker in many organizations," according to a recent study by Gartner and the Financial Executives Research Foundation.[1]

In nearly 500 enterprises surveyed, 42 percent of all CIOs report to the CFO, and in three out of four companies, the CFO has a major hand in all IT spending.

Unfortunately, not all CIOs and CFOs work well together: By not accounting for one another's viewpoints, they often fail to build a good working relationship.

WHAT'S A CIO TO DO?

The study recommends this: "CIOs must understand the impact their CFOs have on technology decisions in their organizations, and ensure that they are… communicating the business value that can be achieved."[2]

At a conference last fall, Gartner went even further. "2010 marks the year in which IT needs to demonstrate… business objectives for every investment," said its analysts. "CIOs need to model the economic impact of IT on the overall financial performance of an organization."[3]

For many CIOs, that's a new way of looking at things. But why not start thinking more like a CFO? Why not find ways to stretch your IT budget like a CFO does?

THE CAPEX VS. OPEX DIVIDE

One classic way to stretch your budget is to shift capital expenses to operating expenses. Not sure of the difference? Table 1 sums it up.

As you can see, capital expenses are long-term investments. The drawback is that you pay all the money up-front, but you get the value back in a trickle over the next few years.

On the other hand, operating expenses are pay-as-you-go. You pay by the month, and you get value every month.

	Capital Expenses (CapEx)	Operating Expenses (OpEx)
Purpose	To buy assets with a useful life beyond the current year	Ongoing costs to run a business
When paid	Lump sum (or financed, with extra charges)	Monthly
When accounted for	Over 3 to 10 years, as an asset depreciates	In the current month or year
Listed as	Property or equipment, depreciation	Operating cost
Tax treatment	Deducted over time as asset depreciates	Deducted in current tax year
Example	Buying a laser printer	Buying paper and toner for printer

Table 1: The Differences Between Capex and Opex

TODAY, CAPEX IS OUT AND OPEX IS IN.

As a recent article in ComputerWorldUK put it, "In the pursuit of maintaining a lean balance sheet with optimum cash flow, boards are paring back on new capital investments (CapEx), opting wherever possible to fund projects from operating expenditures (OpEx) instead."[4]

One reason for this is the rapid changes in technology. For example, new servers run faster, use less energy and provide more cores every year. It doesn't make sense to sink money into equipment that's surpassed by the very next model.

The rapid rise of SaaS, outsourcing and managed services shows that many things that were once do-it-yourself are now outsourced to service providers. Costs are reduced and shifted from capital expenses to operating expenses, which save money and look better on financial statements.

AN EXAMPLE: BUYING A LASER PRINTER

Suppose a group of users complain they can't get the 11x17-inch color printouts they need for trade shows. Your nearest color printer that can do the job is in another building half a mile away.

Like a good CIO, you listen and propose to get them a new printer.

Buying the printer means making a lump-sum capital expenditure. Of course, the printer will last longer than one year. So even though the cash to pay for it will be gone, your company won't be able to expense that full cost this year. That asset will be carried on your company's books for the next three years.

If the printer costs $6,000 your company can claim $2,000 in expenses this year. Next year it can claim $2,000 in depreciation; then in Year 3 the final $2,000.

What's wrong with that? Nothing, if you have lots of money. But everything, when you're under pressure to do more with less.

When you propose this to your CFO, he will probably ask a lot of irritating questions:

- How vital is that new printer?
- Why can't they get printouts delivered from the other building?
- What if we spent that money on something else?

For example, if your company spends $6,000 more on marketing, that can generate more sales. That $6,000 cash could become $12,000 or $20,000 in income, which looks much better on the books than a $2,000 capital expense plus $4,000 in future depreciation.

The point is: if it's not tied up in a new laser printer, that money could be working harder for your organization.

AN ALTERNATIVE: OUTSOURCING THE COLOR PRINTING

Suppose you find out your users need about 150 11x17-inch printouts a year, which they can get from an outside printing service for $4 a pop, with free delivery.

That means they can get all the big color prints they need for $600 a year. This transforms a potential $6,000 capital expense into a $600 operating expense. Any CFO would prefer this option.

Why? This saves your company $5,400 in cash to invest somewhere else, and it avoids carrying another $4,000 in depreciation for the next two years. Your users, perhaps with a little grumbling, will likely be satisfied.

This is what Gartner means by modeling the economic impact of IT decisions on your company's financial performance. CIOs who think this way are ready to form a powerful partnership with their CFOs.

OUTSOURCING YOUR SERVER MANAGEMENT

To carry on this thinking, here's an area where most IT departments can easily do more with less: outsourcing your server management.

Before you reject this idea, consider about these comments from CIO magazine.

"As one colleague who consults on financial strategy with many large companies said, 'You know what we think of IT? We think it shows up, spouts unintelligible jargon, and asks for huge lumps of cash...'

"It's easy to understand why any initiative that promises to reduce lumpy capital investment and transform it into smoother operational expenditure would be extremely attractive to bean counters."[5]

If your CFO could save money on servers, push capital expenses into operating expenses, and get the same level of service for your users, would he be interested?

Of course he would. So why not consider this yourself, instead of waiting for him to suggest it?

Today you can move to an innovative form of outsourcing—managed colocation – that takes care of all your hardware. It still leaves you in control of the things that matter most: your OS and software apps. And it cuts several items from your budget and transforms a large amount of CapEx into OpEx.

Table 2 lays out the differences between do-it-yourself server management, traditional colocation and the Managed Colocation available from a vendor like Rackspace. Capital expenses are shaded in grey; operating expenses are not shaded. Dollars are estimated, where $$$$$ is a lot and $ is a little.

	Do-It-Yourself	Traditional Colocation	Managed Colocation
Purchase equipment, or	$$$$$	$$$$$	—
Lease equipment	—	—	$
Finance charges	Maybe? $$	Maybe? $$	—
Space and racks	$$$	—	included
Ping, power and pipe: network, electricity and HVAC	$$$	$	included
Repairs to equipment	$	$	included
Software license fees (could be capital expenses)	$$$	$$$	$$ (with volume discount)
Software support fees	$$	$$	$$
Vendor management: Hardware, network, OS, apps	$$	$$	$ (software only)
24/7 Hardware support staff	$$$$$	$$$$	included
Insurance, certifications, bonding	$$	$$	included
24/7 Software support staff	$$$ (on-site)	$$$ (on-site/remote)	$$ (remote)

Notes: Capital expenses are shaded in grey; operating expenses are not shaded. Dollars are estimated, where $$$$$ is a lot and $ is a little.

Table 2: Comparing DIY, Traditional and Managed Colocation

In the column for managed colocation, notice all the areas that are already included—and the total absence of any shaded capital expenses.

Moving to this pay-as-you-go option, with a strict Service Level Agreement, will certainly help you do more with less. You'll have less headaches from middle-of-the-night hardware failures, too.

And this will enable you, if you want, to use new servers every year, so that your equipment also does more with less. More and more CIOs today think that's a win-win situation; and so do their CFOs.

To see more on how you stretch your IT budget to do more with Managed Colocation, visit www.rackspace.com.

ABOUT RACKSPACE

Rackspace® Hosting is the world's leader in hosting. The San Antonio-based company provides its customers Fanatical Support® in their portfolio of hosted IT services, including Managed Hosting, Cloud Computing and Email and Apps. For more information, visit www.rackspace.com.

1 : "Gartner and FERF Survey Reveals That the CFO is Becoming the Top IT Decision Maker in Many Organizations," Gartner press release, May 3 2010
2 : Ibid Gartner and FERF
3 : "Gartner Says IT Spending to Rebound in 2010 with 3.3% Growth after Word Year Ever in 2009," Gartner press release, Oct. 19 2009
4 : Keith Tilley, "CapEx vs OpEx: Is it time to outsource your data center operations?," ComputerWorldUK, Nov. 28 2009
5 : Bernard Golden, "Capex vs. Opex: Most People Miss the Point about Cloud Economics," CIO, March 13 2009

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