CAPEX VS. OPEX

The Financial Implications of Going Cloud

By Avaya

Many factors make migrating to the cloud a compelling option: reduction in total cost of ownership, standardization, centralization, outsourcing of IT complexities, reduced time to market for new business applications, and the ability to stay current with the latest technology updates and vendor software releases. Small, midmarket, and large enterprises must weigh and rank these drivers differently. And, of course, every business has its own priorities. Still, one business driver is resonating with just about every CIO and CFO these days: the possibility of moving from a financial model geared around capital expenditures (capex) to one based around operating expenditures (opex).

Some enterprises are simply more geared toward the capex model of on-premises computing. Others, such as startups or other small to midsize companies, embrace the ability to avoid large upfront cash payments for licenses and new hardware. They'll likely opt for public cloud and hosted services offering opex-based subscription models, despite any functionality they might be giving up in the process. It's like riding the subway (i.e., public cloud) to work rather than driving your BMW (private cloud): The subway may not be as fast or as luxurious, but it does provide an easy, inexpensive commute. Indeed, the allure of conserving cash is so strong that some experts are even bullish on opex for established companies.

"There's little reason to make big capital bets on products, markets, channels, or projects in times [like these] when demand is highly variable and the likelihood for any initiative's success is anybody's guess," comments Susan Cramm, President of Valuedance®, an executive coaching firm specializing in information technology.

In unified communications (UC), the decision is muddled by the youthfulness of cloud-based UC systems, or UCaaS (unified communications-as-a-service). "As of 2013, I believe that the market had not yet reached full maturity to justify a migration to the cloud," asserts Mike Taylor, CTO of Strategic Products and Services (SPS), a systems integrator of business communications technologies. "Cloud-based UC is not as mature or sophisticated as cloud CRM, for instance."

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As a decision-maker for your business, how should you weigh the pros and cons of these two financial models? Consider these factors:

1. UC is different: Extra costs are always involved.

Whether they choose a public cloud, private cloud, hybrid cloud, or on-premises UC solution, companies will typically have to fork out some cash

Business drivers for migrating to cloud

- Shift from capex to opex model.
- Reduction in total cost of ownership (TCO).
- Pay-per-use model provides great financial flexibility.
- Outsource IT complexities
- Stay current with latest updates.
- Most scalable, cost-effective offering of collaboration solutions.

for hardware and networking even when choosing an opex-based model. Upgrading to IP desktop phones can be one reason, especially if they are not bundled with a provider's service fees. The need for local survivability (with local gateways) and enhanced reliability might be another reason to invest in additional hardware. Also, companies often choose to upgrade their networks, since some collaboration technologies can push their networks to the limit. Video conferencing is one obvious cause; mobile devices are another. It's not just bandwidth. New services and more devices running over a converged voice and data network create management complexity that next-generation networking technology can help address.

"We've found that in a typical cloud versus on-premises UC deployment, the core economics are pretty close over the project term, and the decision often comes down to the firm's preferred financial or operating structure," says Gerry Pearce, Vice President of Services Development at communications systems integrator ConvergeOne.

2. How many people will be using the system?

To take advantage of the economies of scale and support in the public cloud, companies tend to focus on applications used by a significant percentage of workers. "In a hosted model," explains Taylor, "applications that have broad acceptance are usually less expensive than those that do not."

3. How volatile is your business?

If your company is growing quickly or experimenting in risky markets or product lines, going with a public cloud provider helps you to hedge your bets. That way, if your business changes dramatically, you won't lose a large investment of capital and time from installing a new system that no longer meets your needs. The cloud provider can also scale up or down to meet your demand more easily, passing on greater service and value to you.

4. What is your CFO's orientation on IT financing?

In many companies, the CFO has considerable influence over IT purchases. A CFO may have an inclination toward either capex or opex, or view vendor and system decisions from a longer-term TCO perspective, says Taylor. "We have had a number of customers get really far down the road with an opex-based cloud model, but then the CFO shoots it down. The numbers tell the CFO that, over a seven-year TCO, UC is often more costly in the cloud and hard to justify."

"On the other hand," says Pearce, "the predictable cost structure of a cloud-based deployment, especially

for companies that have a limited support staff or a workforce that fluctuates seasonally, can have a significant impact on the buying decision."

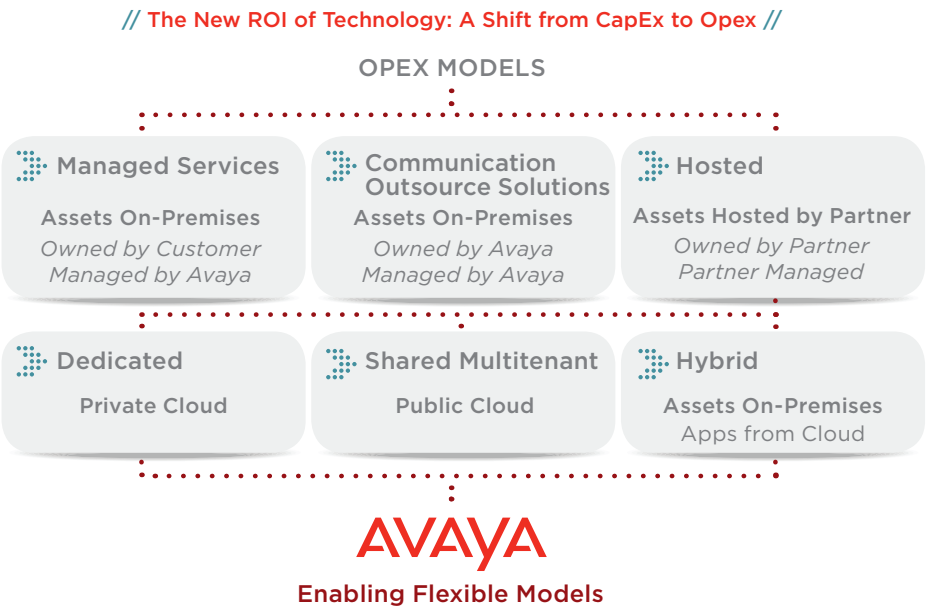
5. How much sway do business execs have on IT decisions?

Gartner predicts that by 2017, CMOs will be spending more on IT than CIOs. "There has been a shift in UC buying decisions from solely the telecom and IT teams to include marketing and sales groups, in part because collaborative UC features have a direct impact on sales and the customer experience," says Pearce. "Business leaders prefer Opex—and, therefore, SaaS [software-as-a-service]—because the predictable pricing makes forecasting much easier. For complex UC integration projects, it's important to work with both the IT teams and the business units to align the financial priorities with the technology purchase."

Does It Even Matter?

Some experts say that the "capital versus operating expense" discussion is irrelevant. "The core issue is not the cost of the hardware and whether you pay for it upfront or over time," says Timothy Chou, a *CFO* magazine columnist who teaches cloud computing at Stanford. "Really, who cares? The real question is, what is the cost of managing the security, availability, performance, and change of the computers and storage, for example?" The rule of thumb, claims Chou, is to take the purchase price of a computer and quadruple it annually to determine the cost of management.

Business requirements and goals are now trumping cost at many companies. "Our clients still look at functionality over costs, because having the right functionality brings profits," says Scott Kaplowitch, partner with accounting and CPA firm Edelstein & Company LLP. "The capex and financing discussion is just not



as important anymore in the cloud as it was a few years ago." Even though there are tax implications of owning or renting technology, that isn't a big enough topic to sway decisions either, he adds. "There are other ways to reduce your taxes, if that's your goal."

CFOs and CIOs need to consider whether their companies can in fact manage the technology more cheaply and better than an external provider that specializes in UC. This requires a detailed analysis of IT spending, which is still rare, according to Bernard Golden, Senior Director of Cloud Computing Enterprise Solutions at Dell. "Five years into the cloud computing era, most IT organizations still have very little understanding of their costs to deliver resources, especially at a fine-grained level."

To be thorough, companies should figure out where they are today, then educate themselves about the many cloud service providers and system integrators globally. There are professional services organizations that specialize in helping companies achieve meaningful business results by designing, building, and managing their UC in the cloud. Additionally, they can easily assess and determine the optimal cloud communications solutions and delivery model for the company, Chou says. "This approach allows them to look at different scenarios and model the different outcomes. You'd do that if you were planning a trip to Rio, so why not do it for a trip to the cloud?" [A]

// Customer Buying Behaviors Are Different //

Enterprise	Midmarket
Decentralized purchase decision	**Centralized** purchase decision
Extensive internal IT support w/outsource	**Minimal** IT support, risk-averse
Large **annual fixed** budget	Smaller **project-based** budget
Complex, customized multivendor, highly scaled—integration critical	**Limited customization**, 1–2 vendors
Evolutionary/migratory sale	**First-time or legacy replacement** sale
Technology: **Productivity, infrastructure management**	Technology: Mission-**critical to compete and grow**
Installed solutions drive brand preference—seek **advice from vendor**	Favor loyalty and simplicity over brand—seek **advice from channel partner**

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