

CAPEX vs OPEX

With finances constrained and liquidity rarer than a cold bottle of water in the desert, enterprises are being forced to reevaluate how they finance their IT infrastructures. But what is the difference and which is better?

Few CIOs would describe finance as being near the top of the list when it comes to their favourite conversational topics. But as IT moves away from the traditional approach of buying in equipment, then ripping it all out and replacing it years later, the issue of finance is moving away from the (relatively) simple questions of can we afford it, what is the opportunity cost and how long will it take to see an ROI, towards the respective

benefits of capital expenditure (CAPEX) versus operational expenditure (OPEX).

While the terms themselves might not be unfamiliar to CIOs and other senior IT figures who have spent any amount of time in the boardroom, the actual difference between the two and the impact they have on IT purchases can still be unclear.

At its absolute basic level, the difference between CAPEX and OPEX is the same as the difference between private and public

clouds respectively. One requests a significant capital investment and is owned by the enterprise itself, while the other is a service and is paid for as an operational expense.

Much of the attention that has been placed on OPEX-based services lately, has been focused on the idea that they can be significantly cheaper once interest on any necessary gearing is taken into account, in addition to their ability to lower financial exit barriers, and the impact on other fixed costs, such as staffing and maintenance. OPEX-based provisions can also have the added benefit of reducing tax-liability in countries that charge corporation taxes. However, while it might be easy to dismiss vendors' cries that OPEX isn't the be-all-

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ASSET EXAMPLE

Asset: Company X Blade Servers

Capital cost: US\$40,000

Managed service cost for same processing power: US\$650p/m

Year three cost: US\$835p/m

Year four cost: US\$665p/m

Year five cost: US\$555p/m

and-end-all of financing IT infrastructures, there are genuine reasons why it might not be the best approach for all enterprises.

For enterprises that are cash rich, have long refresh cycles on their IT investments, and where short-term profits are less important than long-term ones, a CAPEX approach maybe more suitable, especially if the amount leveraged in the beginning ends up being less than what the OPEX expense would have been at the point of refresh.

The obvious problem with that is in an industry that moves as fast as IT does, it can be hard to work out whether the IT solution a company is planning to invest in will still be relevant, suitable or even supported at

the point in the future when the refresh is planned. The other major issue for enterprise CIOs is that the best value deal isn't always the best value.

"Ultimately a customer is likely to pay for everything it gets from a supplier, whether the payment is made via capital payments or operating expenditure," says Dan Levy, head of financial solutions at BT Global Services. "The difference between the two methodologies is essentially one of timing and of control – will the payments be made upfront or over the life of the contract.

"The cheapest cost of capital – whether it is the customer's cash or from the customer entering a lease with a leasing specialist – will lead to the best value deal," he adds.

"It all depends on the circumstances," echoes eHosting Datafort CEO Yasser Zeineldin. "If, for example, it would take eight years to pay off an asset at the cost of the service deal, then it depends whether the asset will need to be refreshed before or after that date. If it's the former, then it doesn't make sense to invest in it as a capital asset; it is financially smarter to position it as an operational expense through a service partner. However, if it is the latter, then in the long-run, it will only end up costing the company more in the long run." It is a point that BT's Levy agrees with. "Only very rarely will the best deal involve the service provider owning the assets."

The reality of CAPEX and OPEX is that it is a very personal decision for the enterprise CIO. However, it is one that has the potential to make or break it at the same time. **ACN**

Choosing the wrong solution can end up costing you money.

WHAT'S THE DIFFERENCE, REALLY?

Business is full of acronyms that, to be quite frank, should be made illegal. Terms like synergy, paradigm shift and thought showers are all prime examples of words and phrases that have been invented by bland and boring executives looking to 'spice up' their presentations.

Luckily CAPEX and OPEX don't belong to that category. However, due to the way that people use those terms, there can be some embarrassment if you have to admit that you don't know what they mean. Here's a quick breakdown for you.

CAPEX (Capital Expenditure)

Capital expenditure is a cost that is incurred when a business spends money either to buy a fixed asset (like a server) or add to the value an existing asset (such as adding RAM to a computer).

This is the method that IT infrastructures have traditionally been built up using. The benefit is that it is a one-off payment and over its lifetime, can result in significant savings. However, the return on investment can be quite high, and in times of low equity, it can stifle growth.

OPEX (Operational Expenditure)

Operational expenditure is incurred in the course of ordinary business, and refers to anything that the business needs to run.

In regards to IT infrastructure, a cost that would be classed as an operational expense is one for a service (such as public cloud computing).

The benefit of operating expenses is that when a company pays for a service through lease or rent, they are cheaper over a shorter period of time, and they can be tax-deductible in the relevant period.