

To Buy or Not To Buy

Pay-as-you-go vs Capex vs Opex

When it comes to technology investments, what is best for your business?



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1. Introduction

In the complex world of technology investment, choices must be made.

In an ideal world, where money was not a concern, you would do whatever it takes to give every customer the perfect experience every time they contacted your company.

If that meant hugely overstaffing the contact centre so that nobody had to wait, so be it. If it meant buying, or even building, your perfect no-compromise IT solution, you would do it.

Unfortunately, we do not live in that world. There are competing demands throughout the company for investment capital and cash, and a finite amount of each.

Whether you are responsible for customer experience from a financial, technology, or operational viewpoint you will be only too painfully aware that you have to make compromises to balance the risk and rewards in the following three areas:



The kinds of questions you will be asking include: If we throw more money at our CX efforts can we get another percentage on our CSAT scores? Likely yes, but how does that translate to the bottom line? Is now the right time to invest in a new technology, or wait until the next innovation comes along?

Assuming you do decide to invest, there's the biggest question of all: How do we pay for it?

While Pay-as-you-go offers the best balance of risk versus reward in most scenarios, Capex and Opex do still have their place for certain types of investment.



The best are always investing

Two factors are driving businesses to make continued investments in customer contact technology.

The first is that technology these days develops ridiculously quickly. This means that as soon as a new system or some new hardware is installed, there is likely to be something better, faster, cheaper, or with more capabilities just around the corner.

At the same time, organisations are under greater pressure than ever to deliver the best customer experience. As products and services have become homogenised in many sectors, service is often the biggest differentiator, sometimes even more so than price.

For many companies this means a near continuous investment in IT is necessary to keep up with the competition. While this can still be onerous even for larger organisations, for small businesses and start-ups finding the constant cash is almost impossible.

In this short guide we look at the different options available to companies when looking to introduce new IT capabilities, or upgrade or replace their existing systems.



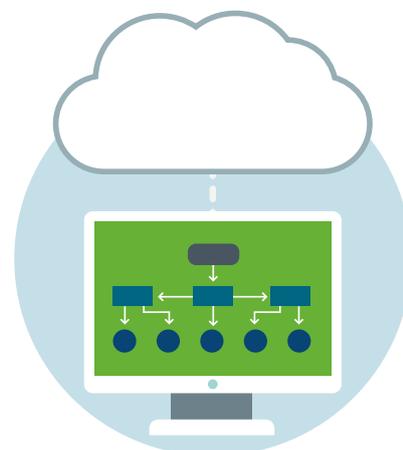
2. Investment options

Pricing models for IT investments have generally been either Capex (capital expenditure) or Opex (operational expenditure) based.

Capital expenditure is an up-front investment where you buy your new system or software outright. It depreciates over a period of time like any other business investment.

Operational expenditure usually involves a monthly or quarterly lease of equipment or software, perhaps on a per-seat basis. Costs immediately impact the bottom line but are tax deductible in the year they occur.

A third option has been pioneered by cloud computing and SaaS (Software as a Service) providers. It is called Pay-as-you-go and overcomes many of the limitations, even of the Opex pricing model.



Assessing models

As we have already seen, the decision of whether to invest in new technology is about balancing risks and rewards.

A company that purchases on a Capex model is taking on all the risk that the technology does what it was bought to do, doesn't go out of date too quickly and has the expected business benefit. The vendor gets paid upfront for the lifetime use of the technology and so the pricing should reflect this.

In an Opex model the risk is more shared out. The vendor gets paid by use so its in their self-interest to keep the technology up-to-date and continue to add features to retain users. As a purchaser you always have a way out of the relationship if it isn't working out. While you would expect prices to be higher over a comparable lifetime than with Capex, you would also expect prices to reduce the longer you commit as that means you're taking on more of the risk.

With the Pay-as-you-go model, the supplier is taking almost all the risk as the user has ultimate flexibility to switch to a competing solution at any time. While you would expect to pay a premium for that flexibility – which includes of course the ability to scale as well as switch – economies are made because you only pay for what you use.

Companies will choose a mixture of Capex, Opex and Pay-as-you-go for different parts of a single project. But, as more businesses in global, fast-moving and low-margin markets need to adopt

just-in-time and on-demand acquisition policies these days, we recommend the Pay-as-you-go model more and more to our users.

Questions

Would capitalising an investment and depreciating over 3 to 10 years deplete our cash reserves to a point which is unacceptable?

If YES consider Opex or Pay-as-you-go

Would making a multi-year investment risk not being up to date with customer expectations and experience?

If YES consider Opex or PAYG

Would we want to cost each of our projects accurately by assigning accurate costs?

If YES PAYG

Are we happy to have spare capacity and simply assign infrastructure costs across all our projects?

If YES Opex.



2.1 Capex



Long-favoured by the C-suite because of its tax advantages, Capex is the way major investments have been made since the concept of capital itself was invented.

How it works

At its most simple level the acquiring company pays in full for whatever it is buying and from that point on it owns it outright. How the acquirer pays – whether using its own cash reserves, or by gaining finance – adds levels of complexities we don't need to go into here.

Capex should be used when a company acquires an asset that will be of benefit for more than a single year. Depending on your company's jurisdiction, different tax and accounting rules will apply, but in general capital investments are depreciated over 3 to 10 years, delivering a tax deduction every year that the company benefits from their use.

Advantages

When investments are necessary, finance officers will often prefer a Capex route because it demands stable long-term planning and budgeting. An investment may have to deliver its ROI (return on investment) over a 5-year period. Everyone involved – usually finance, IT and operations – will have agreed exactly how the new software or hardware being purchased will be used to generate that return.

As the purchase has been made, there is also full visibility of all the costs involved over the useful lifetime of the system being bought. It is also an asset on the company's balance sheet, which can be a big determiner of the value of the business. From an operational viewpoint, the company owns its new system and can do whatever it wants with it, free of the limitations vendors often impose on users.

Disadvantages

Having to find, or part with, a large sum of money in one go is the major disadvantage of buying on Capex. For cash rich companies this is great, but not everybody has Apple's swollen bank accounts. Smaller companies and start-ups are much more susceptible to cashflow fluctuations than established businesses and can find it difficult to make such large outlays.

How to calculate ROI

As the purchase value is depreciated over a number of years, the return on investment has to be calculated over the same period. The things that need to be considered include:

Return on Investment (ROI): Revenue earned from an investment compared to the amount invested, expressed as a percentage. This can be calculated annually and over the whole lifetime of the investment.

Break Even Period: An estimate of the amount of time it will take for the revenue earned to equal the amount invested and so break even.

Useful Life: Most IT systems will be obsolete within 5 to 10 years or sooner. You need to ensure your Pay Back Period is within this timescale.

Residual Value: This is an estimate of how much you could potentially sell the equipment for at the end of its useful life.



2.2 Opex



While businesses have always made purchases labelled as operating expenses, what's new in recent years is the widening of this category of spending to include items that had always been seen as capital investments. That includes, of course, IT equipment and software.

How it works

Operating expenses cover the purchase of the things a company needs to buy regularly to carry on its business. They can include salaries, commissions, employee benefits and pension contributions, transportation and travel, rent, subscriptions, services, repairs and taxes.

In general, Opex is the chosen option when the item being purchased brings a short-term benefit that is accrued only in the current financial year. There is no depreciation as the costs are usually tax deductible immediately.

When it is not desirable or possible to make a purchase all in one go, Opex is the only other option available. Rather than making a giant hole in the bank account and a corresponding addition to the balance sheet, costs are reflected in the monthly profit and loss statements.

Advantages

There are many benefits to taking an Opex approach to medium to long-term IT investments.

The approval process for a large capital investment can be a lengthy and time consuming one, perhaps going right up to board level. Financial forecasting has to be done for perhaps 10 years depending on what is being bought – and in an ever-changing world, any projections of more than a few years are liable to be woefully inaccurate. In just the last decade entire robust business sectors have completely disappeared and others that were not even on the horizon have given rise to companies with huge market capitalisations.

With Opex, on the other hand, all you are talking about is a monthly fee for a service. With some providers offering very flexible contracts, the buyer needn't even be locked in for a long period of time.

For this reason, the approval process doesn't have to be as rigorous, as if the company's business changes, the contract can just be cancelled; nothing has been bought which puts the risk of obsolescence firmly back on the provider.

In a capex model it might also be necessary to buy support infrastructure and other services, or hire additional staff, to make the thing that you've bought work. For example, your shiny new ERP or CRM system might need servers, a data centre, high speed data connections, a whole heap of software, and a team of technicians to make it run.

The beauty of buying the same thing on Opex as a service is that the service provider must take care of all those things. The costs of all that infrastructure will be divided between all the provider's clients. Additional services, maintenance, and updates – which would otherwise require new hires, custom code (and the coders to write it), more equipment and software – can also be added to a contract with a service provider. Indeed, in many cases these things might only be accessed and therefore paid for when needed.

Finally, it is not just over longer periods that a company's need can dramatically change. Many businesses have seasonal peaks and troughs, cyclical business, or may need to quickly pivot. An as-a-service model offers far more flexibility than a bought-and-paid-for solution. If it's just a question of scale, then a flexible contract can allow for both bursting and throttling to cope with increases or reductions in demand.

Disadvantages

With all the advantages of Opex it may be a wonder why anybody would take a Capex approach to IT spending. The fact that plenty still do is just an indication that there are no universally applicable solutions; every case must be decided on its own merits.

With Opex spending, for example, there is no accrual to the balance sheet and the company generates no future capital value from developing its own IP (intellectual property). Where an IT system is absolutely core to the operation, for example where it makes possible a genuinely unique solution – think Google's algorithms, Amazon's e-commerce platform, Netflix's streaming technology – there is a very strong case for outright buying or developing in-house the equipment and software needed to run that system.

From a financial point of view, many CFOs and CEOs prefer to be able to depreciate investment costs over time rather than have these show up in the monthly P&L as operating costs. Where finance is readily and cheaply available, the cost of a large one-off acquisition can be spread over a longer period anyway.



How to calculate ROI

With Opex, the accounting is vastly simplified as the costs are just recorded every month in the company's profit and loss statements. ROI can therefore just be calculated and monitored on an ongoing basis.

Complexity can enter the picture when it comes to allocating those costs between multiple departments, business units, product units and other teams that use the service being purchased. Many service providers however have risen to this challenge and allow more fine-grained tracking of actual usage to allow this.



2.3 Pay-as-you-go

While IT systems, software and contact centre infrastructure have long been available to lease on an Opex basis, the flexibility of pricing hasn't always been what companies want, which means many end up paying for capacity they never use.

Think about how you pay for most services; you only pay for what you consume.

You don't have to tell your mobile phone or electricity company at the start of each month how many minutes or watts you think you'll consume and then pay for it.

Instead you pay at the end of the month only for the minutes or power you did use. This is what we call pay-as-you-go pricing and the major benefit is that you never pay for capacity you don't use. Neither do you have to pay penalties if you use more than you anticipated.

How it works

For businesses that need a little more flexibility, scalability and control, as well as a finer-grained view of their costs, the pay-as-you-go model delivers.

Like in an Opex model, a service is rented or leased and paid for on a monthly basis. However, rather than calculating the fee either at the start of each month or at the start of each contract period, billing is based on actual use.

What that means is that billing is based on a metered unit, which might be time in minutes or seconds, bandwidth consumed, data storage used, API calls made, or combinations of these.



Advantages

The main advantage is that the company only ever pays for what it uses. It never overpays nor under-utilises resources it has paid for.

When it comes to forecasting, rather than having to decide its needs in advance, the service offers much more flexibility, so the company can burst or throttle at a moment's notice and, again, only ever pay for exactly what it uses. The problem of keeping up with the demand is entirely on the service provider's shoulders, and of course the level of service and uptime they are supposed to provide is stipulated right in the contract.

As usage is tracked in greater detail and essentially in real-time, the problem of accurately allocating costs to different units and teams is overcome. The service provider delivers an extremely detailed breakdown of costs, like an enhanced version of your phone or utility bill.

Disadvantages

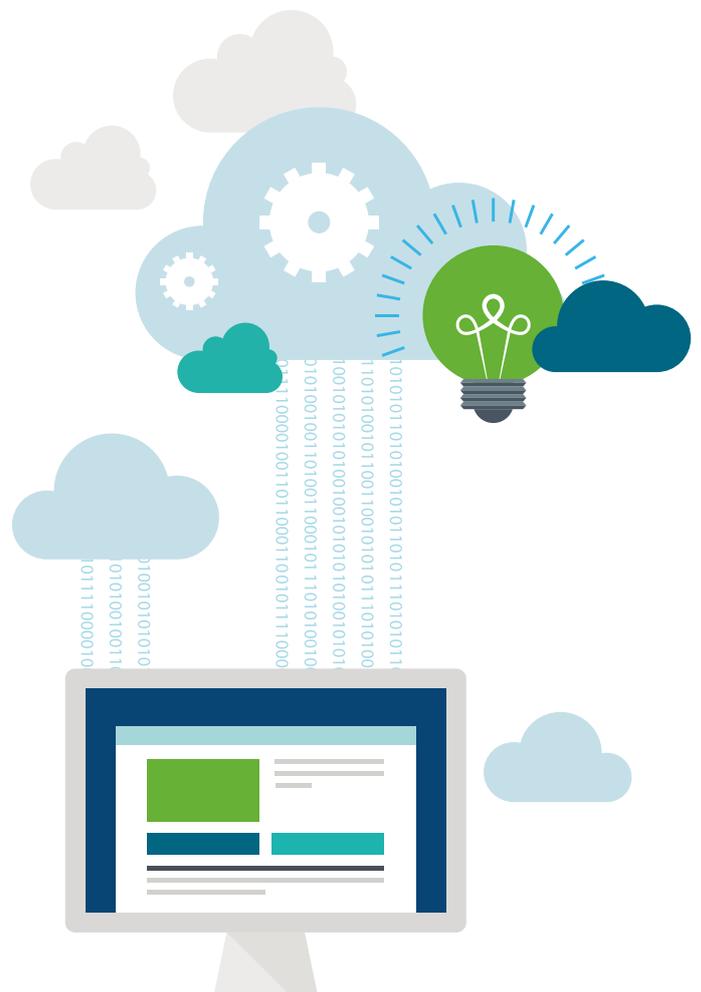
If Opex rather than Capex is the option that has been chosen, then there really are no drawbacks. Pay-as-you-go is the version of Opex spending you would design as a customer if your provider let you. As such, it does have the same disadvantages as outlined above in the Opex section.

How to calculate ROI

It is much simpler to calculate the ROI as costs are broken down by the service provider in greater detail. This means that costs can be

allocated down to the last penny or cent, potentially in near real-time which is great particularly for smaller businesses which need to make resourcing decisions on the fly to maintain profitability.

Costs can also be allocated on a micro-scale and allocated to individual projects and even teams within projects. For managers who like to know the ROI of each unit of a project – which is most managers these days – this level of fine-grained billing detail is a great benefit.



The best balance of risks and rewards

Looking back at our risk diagram, the Pay-as-you-go model generally offers the optimum balance between the financial, technology, and customer experience risks.

Financial risk is lower because you only pay for what you use, and you can stop at any moment meaning you have no long-term exposure.

Technology risk is lower because the vendor is incentivised to keep updating and improving the

technology so that you continue to use it, and because you can switch at little to no cost if something better comes along.

Customer experience risk is better as you can almost guarantee that you will have access to the very latest, cloud-based, API-enabled solutions as by their very nature these are the ones most suited to a Pay-as-you-go model.



3. Pay-as-you-go with Infinity

Infinity CCS's desktop and workflow solutions have always been available on a Capex basis to purchase outright, or a traditional Opex model based on seats and licences.

To help make cutting-edge CX technology an affordable reality for small and mid-sized businesses, or contact centres within larger organisations, we have launched a Pay-as-you-go hosted contact centre solution.

It is simple to implement and easy to integrate with existing systems. Organisations will now only pay for their actual usage of the Infinity platform.

With Infinity's solutions, organisations no longer need to dedicate valuable resources to building costly infrastructure, including purchasing servers, software licenses or leasing facilities.

Instead you can replace large upfront expenses with lower variable costs and pay only for what you use and only for as long as you need it. All Infinity services are available on demand and require no long-term contracts and have no complex licensing dependencies.

Pay-as-you-go pricing models can not only save costs but allows businesses to link every penny spent to their revenues. This hasn't always been possible in the past as IT expenditures and campaign revenues tended to be disconnected. For teams that are targeted on their commercial results, and for companies like BPOs that need to calculate profit and loss for each client, this is an important capability.



To arrange a demo of our pay-as-you-go solution, and to discuss how we can adapt it to your needs, please get in touch.

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