technologyone | IBRS ANALYSIS INSIGHT JUDGEMENT

Revisiting your financial approach:

Capex vs Opex in an as-a-service world

Contents

Introduction

With the arrival of cloud computing, mobile apps and other digital innovations, the information technology (IT) systems needed by organisations have changed dramatically.

In turn, business leaders are having to explore new funding models that can keep pace with rapid change in both technology and the expectations of customers, staff and other stakeholders.

The evolution of IT spending and funding

Traditionally, most organisations invest in technology in waves. Each five-to-seven years, businesses must review a range of options, then make significant up-front capital investments in the computing hardware and other equipment they'll need for the next period.

The organisation must also make long-term bets on the software they believe will best serve their requirements.

Accordingly, businesses tend to receive funding from governments and other stakeholders in lump sums, which are used to buy, install and manage hardware and software. Some of this funding is in the form of grants that are provided explicitly for capital expenditure. Accountants then list IT systems as capital assets on the organisations' balance sheets and typically depreciate their value over five-to-seven years.

This approach worked reasonably well in the era when IT changed relatively slowly, was largely run on-site, and before users' expectations were changed dramatically by ubiquitous, high-speed broadband, cloud computing and the smartphone.

All these factors have clearly changed, and are leading organisations to purchase technology in fundamentally different ways.

This, in turn, is driving a need to revisit the financial approaches that have traditionally been used by most organisations.

From Capex to Opex

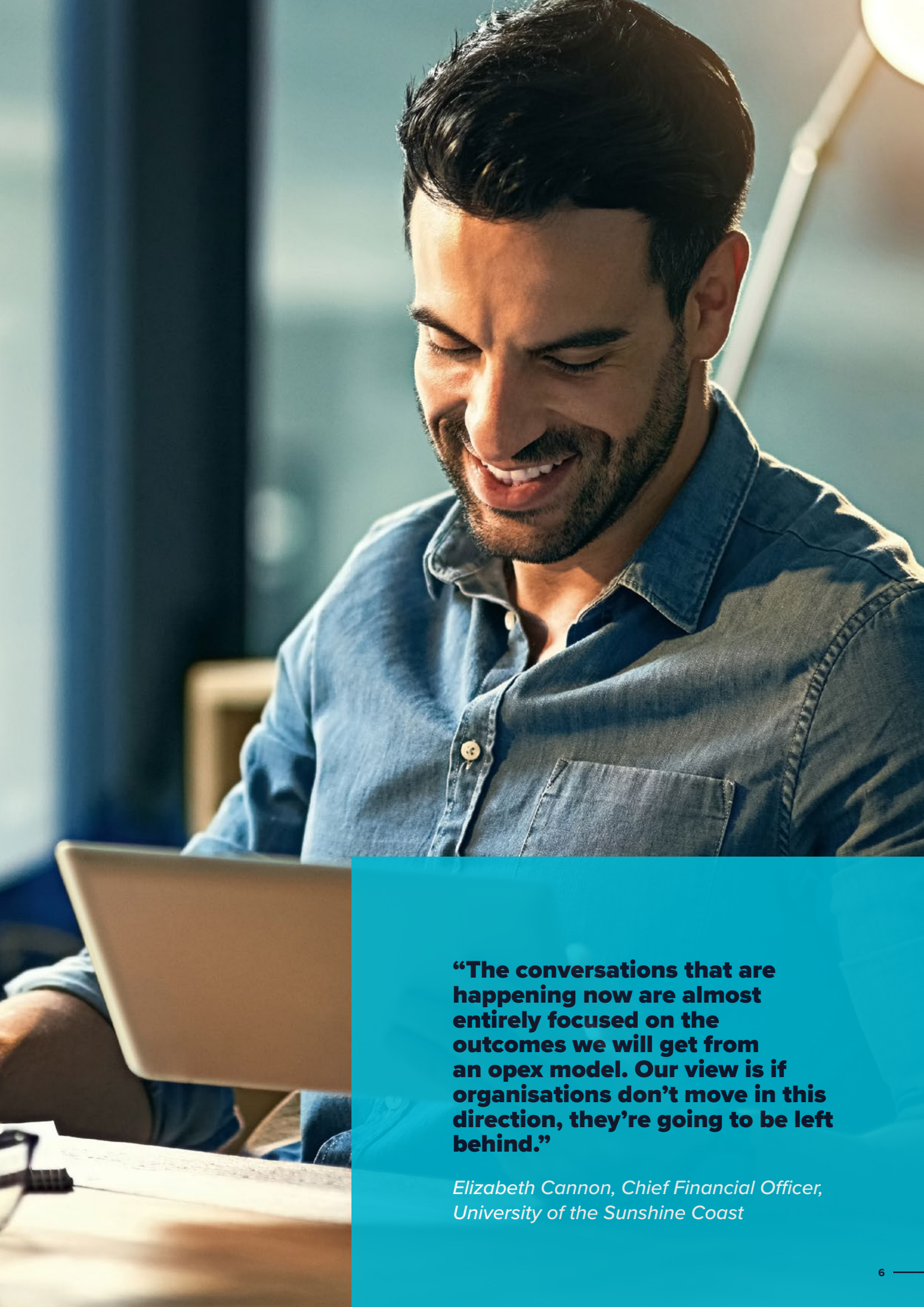
To overcome these challenges, businesses now need to upgrade their back-office IT systems more frequently. There is also a need to access more computing capacity, often at irregular times across the year due to variations in peak periods or the implementation of new digital initiatives. Making such improvements often necessitates spending large amounts on core IT upgrades, which isn't always feasible.

To solve this problem, organisations across many industries are adopting a different IT spending strategy. Instead of using large portions of their IT budgets buying IT equipment and software (a capital expenditure or 'capex' model), organisations are leasing IT solutions under an operating expenditure (opex) model. In fact, it's becoming difficult for organisations to acquire software on a traditional one-off or perpetual licence basis from any vendor.

This new opex approach includes subscribing to Software as a Service (SaaS) solutions. These solutions reside in the cloud on servers owned and managed by a third party. They are delivered to users over the Internet, instead of being hosted on servers that organisations own or control.

Among the leading organisations that are now adopting this more opex-centric IT model is Sunshine Coast University. This shift has enabled it to gain access to flexible computing power and up-to-date software applications, while transforming the way it delivers services to its customers.

"The SaaS business model pushes the management of IT risk onto the service provider whose business posture and cost base is better deployed managing that risk, leaving businesses to focus on what they do best - meeting service level requirements and fulfilling customer needs."



“The conversations that are happening now are almost entirely focused on the outcomes we will get from an opex model. Our view is if organisations don’t move in this direction, they’re going to be left behind.”

Elizabeth Cannon, Chief Financial Officer, University of the Sunshine Coast

Financial benefits

Buying computing capabilities as services from external providers – rather than large, on-site assets – can deliver a range of financial benefits to organisations.

While SaaS fees add up over time – they are typically charged on a monthly, quarterly or yearly basis – they are more predictable than capital expenses and organisations don't need to find large lump sums. This makes it easier for business leaders to plan strategic IT projects.

The SaaS fee schedule may also provide tax advantages. Organisations can categorise these fees as operating expenses and claim them as tax deductions. Because they pay SaaS fees on a recurring basis, they can claim those deductions every year.

Whangarei Council's move to SaaS allowed it to replace core IT systems that were more than a decade old. In the year since switching to SaaS, the council has reduced its total cost of IT ownership by 38 per cent and shaved $280,000 off the bottom line operationally. Staff and community members can now use their phones to access a range of services via an intuitive, highly accessible platform.

Staying up to date

A capital-heavy IT strategy often forces staff members and customers to use outdated technology, because the organisations they are working for or engaging with need to wait five years or longer before upgrading core IT systems.

This prevents staff and customers from taking advantage of new software features, faster servers or other technology advances that make it easier to operate.

SaaS solves this problem by providing organisations with a regularly updated back-office solution. The SaaS vendor frequently updates the SaaS solution and those updates are included in the SaaS subscription fee.

This approach gives organisations a technology advantage. For example, it makes it easier to access new developments in areas such as data analytics, workflow automation and mobile application delivery. Renting access to these features is much more economical than building them from scratch or upgrading the software and infrastructure needed to enable them.

Freeing up IT teams and engaging business units

As-a-service enterprise solutions are breaking down the traditional dynamic between business and IT, according to a recent study by IBRS.

Traditionally, the IT function is driven to ensure applications, networks and technology infrastructure run smoothly to the point of being invisible. They spend a lot of time keeping on-premise software applications and associated data centre hardware running – otherwise known as 'keeping the lights on'.

This work includes supporting users, and upgrading and installing software, servers and storage devices. IT employees might manage separate software environments – including separate installations of the same application in each environment – for different groups or departments. These tasks drive up administration costs and prevent IT employees from doing more engaging and strategic work, such as developing innovative digital services.

The complexity of IT environments, the rate of change, the cost pressures, the increasing security risks and the growing needs of the business has resulted in many IT teams straining to deliver, let alone provide innovation and improvements.

The IBRS report says that with a move to SaaS (and an opex strategy), IT could be liberated from this focus on failure avoidance and instead turn its attention to continuous improvement and innovation.

As the SaaS provider manages the solution and associated data centre infrastructure, this eliminates a lot of administrative IT work.

It also allows business units to take more control over the budget, selection, procurement and deployment of their business-critical systems. Business units are able to contract the services they need to receive timely upgrades and deliver to their customer service and mobility needs.

IT can then take on more of a governance role, to ensure the service is safe and secure, has the integration capability needed to support business processes across the organisation and has the right commercial arrangement to ensure the business gets what it expects.

This shift in dynamic has held true for the University of the Sunshine Coast since implementing a Financials Software as a Service solution. The IT department now spends less time managing the university's finance system and more time improving the student experience.

“If you’re not using the latest version of a product, and that product isn’t operating at its best you’re really shooting yourself in the foot.”

Case Study

University of the Sunshine Coast

One institution that has moved from making large capital investments in IT to treating technology as an operating expense – and reaped the rewards – is the University of the Sunshine Coast.

The university currently has around 1,500 employees and 15,000 students enrolled. It is on track to achieve its target of 20,000 student enrolments by 2020.

The university's Chief Financial Officer, Elizabeth Cannon, spearheaded the transfer of its financial systems to a subscription-based model.

"Our migration to the SaaS model was largely motivated by mobility, so that our financial delegates, who are always on the move, could approve things on the run," says Cannon.

While the move made life easier for those senior financial delegates at the university, it also had a positive knock-on effect for students – even though the student-facing technology at the university is not yet residing in the cloud.

"The finance component of a university should be seamless. IT resources are now largely focused on student experience, which is where they should be focused – managing and supporting students during their time here, as well as pre- and post-university," she adds.

"IT shouldn't have its resources consumed by a finance system, so by moving that to the cloud, IT now has a very light touch in relation to managing that, leaving them to allocate their time and resources towards improving the student experience."

The success of the implementation has now prompted other departments within the university to look at moving their IT systems into the cloud.

"The conversations that are happening now are almost entirely focused on the outcomes we will get from an opex model. Our view is if universities don't move in this direction, they're going to be left behind," says Cannon.

The service-based model has also been beneficial from a technology standpoint in terms of remaining competitive through innovation.

"If you're not using the latest version of a product, and that product isn't operating at its best, you're really shooting yourself in the foot," Cannon believes.

Next Steps

Organisations that are prepared to reposition their capital funding and operating budgets will be better able to afford modern IT systems. This will position them to lead the way in delivering cutting-edge services to their customers.

The checklist one page 12 is designed to help organisations compare these factors.

#1
Calculate

Calculate the total cost of ownership (TCO) for current on-premise back-office software and estimate the TCO for an equivalent SaaS solution.

#2
Determine

Determine the return on investment (ROI) from a current solution and estimate the potential ROI from using SaaS. This might include an increase in revenue due to the ability to process transactions faster or launch new services more easily.

#3
Examine

Examine the intangible costs and benefits of bothstrategies. For instance, the improvement in an organisation's reputation from offering more services online or streamlining its customer-facing processes.

Learn more

By adopting an opex IT model, businesses can benefit from predictable and affordable IT services, while staying up-to-date with the latest innovations in the market.

They can also reduce IT administration costs and free up funds and IT teams to streamline and enhance the experience for their customers and staff members.

To learn more about how SaaS is changing the enterprise software landscape, download your copy of the 2019 Enterprise Software Report at **technologyonecorp.com/2019EnterpriseSoftwareReport**

Checklist

On-Premise and SaaS Comparison Points		
Total cost of ownership	**On premise**	**SaaS**
Software costs - up-front and recurring fees		
IT infrastructure costs - cost of servers, storage and network, including overheads		
IT administration costs - cost of software and hardware administration, including deployment, monitoring, upgrades, integration, securing systems, backing up data, providing mobile access and supporting users		
Return on investment		
Estimated financial gain resulting from an increase in the number of payments processed, customers registered, or services launched. This could be due to increased application performance, scalability and uptime, faster deployment time or other factors		
Other Factors		
Simplicity – ease of upgrading, risk of integration problems and effect on IT team's ability to support strategic business projects		
Productivity – ease of use, interface design, efficiency of application workflows, ease of mobile access features and frequency of feature upgrades		
Scalability – cost and skills required to add servers and storage quickly		
Security – time, cost and skills required to adequately monitor for threats, prepare for audits, gain certification and comply with regulations. Frequency of security updates should also be considered		

About TechnologyOne

TechnologyOne (ASX:TNE) is Australia's largest enterprise Software as a Service (SaaS) company and one of Australia's top 200 ASX-listed companies, with offices across six countries. Our enterprise SaaS solution transforms business and makes life simple for our customers by providing powerful, deeply integrated enterprise software that is incredibly easy to use. Over 1,200 leading corporations, government departments and statutory authorities are powered by our software.

Our global SaaS solution provides deep functionality for the markets we serve: local government, government, education, health and community services, asset intensive industries and financial services. For these markets we invest significant funds each year in R&D. We also take complete responsibility to market, sell, implement, support and run our solutions for our customers, which reduce time, cost and risk.

For over 30 years, we have been providing our customers with enterprise software that evolves and adapts to new and emerging technologies, allowing our customers to focus on their business and not technology.