CFO innovation INSIGHT ROUNDTABLE

TURNING CAPEX TO OPEX

The Cloud, Outsourcing, Telepresence and Other Strategies

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About This Report

AT&T Asia/Pacific Group, the regional arm of US telecom multinational AT&T Inc., asked CFO Innovation Asia to invite a select group of CFOs, finance directors, controllers and other senior finance executives to a roundtable in Singapore on 9 June 2011. The participants shared their experiences and thoughts about turning capital expenditures into operating expenses as part of their company's cost management initiatives.

This report records the insights of the following participants:

Chia Chey Hui
Country CFO, Singapore and Area CFO, Asean & Pacific, Philips Electronics

Rakesh Dhamija
Senior Vice President and Chief Financial Officer – Asia Pacific, Northern Trust

Steve Dwyer
Director of Finance, Kennametal

Foo Fei Voon
Senior Vice President, Accounts, Sembcorp Industries

Graham Ford
General Manager, Finance Services Operations, International Business Group, Fuji Xerox

Audrey Fung
CFO, AP Region, AT&T Asia/Pacific Group

Jun Tu
Chief Financial Officer, Pepsico Foods (China)

Sirish Kumar
Finance Controller, Asia Pacific, Motorola Electronics
(now Senior Business Finance Controller – APAC Region, Nokia Siemens Network)

Edmund Mah
General Manager, Finance, Keppel Offshore & Marine

Pang Chee Ming
Financial Controller, Asia Pacific Operations, Finance, Steelcase Global Shared Services

Umesh Shah
Vice President Finance UAPL, Unilever Asia

Anil Singh
Chief Financial Officer, Asia Pacific, Tyco Fire & Security

Emmanuel Walter
CFO, SEC AREVA (Shanghai Lingang) Transformers

Felix Wang
Deputy General Manager, Finance & Management Services Department, Itochu Singapore

Eric Weinbrom
Vice President – Finance, AT&T Inc.

Moderator
Cesar Bacani
Editor-in-Chief, CFO Innovation Asia

This report identifies the persons quoted whenever possible. However, some statements are not attributed to allow participants to express views that may not reflect those of their organisation.

Fourteen Asia-based CFOs and other finance executives recently attended a breakfast roundtable with New York-based Eric Weinbrom, Vice President – Finance at US telecom giant AT&T in Singapore. The topic: How to turn capital expenditures – capex – into operating expenses – opex.

This is an important issue in financial management circles. Some companies spend billions of dollars on capex every year, equalling the entire GDP of developing nations. But it seems those billions are still not quite enough.

"It's a function of looking at where the core competencies are in our business versus the things that we can outsource to someone else"

"Like any other company, we spend a lot of time making capital decisions," said a roundtable participant. "If you step back and ask: How can you spend US$19 billion and not have enough? The answer is: It's easy."

The consensus was that turning capital expenses into operating expenses should be part of the CFO's cost management arsenal. "There are various benefits," said Chia Chey Hui, who is Country CFO, Singapore, and Area CFO, Asean & Pacific, at Philips Electronics. Among them: standardising processes, having the flexibility to make changes to projects, i.e., plug-and-play concept, gaining IT flexibility, and optimising use of office space.

Capex Vs. Opex

Internally, said Weinbrom, AT&T faces the same challenges as other companies. "We ask ourselves: Do I want to build this myself [capex] or can I use my partners' facilities to do things [opex]? It's a function of looking at where the core competencies are in our business versus the things that we can outsource to someone else."

It is true that capex can sometimes be more costly than opex. The company will need to pay operating expenses year after year, whereas capex payments end after a pre-determined period. Also, if opex increases, current liabilities may also rise and require financing through short-term loans, which are more expensive than the long-term borrowing that typically fund capex.

However, turning capex into opex can bring great benefits. "The hardest thing with projects [that require capex] is when to stop them," a participant observed. "Some things just aren't going to work and there comes a time when you jut have to stop them. But when people have put money into the project, they don't want to stop." It is easier to pull the plug if the company had not spent so much on servers and other infrastructure by opting for a cloud computing solution, for example.

Rakesh Dhamija, Senior Vice President and Chief Financial Officer – Asia Pacific at wealth management and banking company Northern Trust, recounted his experience in another company. "We were investing in data centres in anticipation of getting a lot more business," he recalls. "But after we had bought, server prices fell dramatically." The company not only lost out on the cheaper prices; the anticipated business also did not materialise, leaving it with excess server capacity.

"Things that are required to keep the lights on could be turned into opex, but things that drive the strategy and value of the business, you have to think twice"

In hindsight, Dhamija felt that it would have been the better option to use the servers of a company like AT&T, "because they've got the scale and that scale is so significant that they could have

From left: CFO Innovation's Cesar Bacani, Anil Singh of Tyco, Eric Weinbrom and Audrey Fung of AT&T

gotten a price that's 30% to 40% better than we did." And when the anticipated business did not materialise, it would have been easier for the company to pull the plug without worrying about how much was spent.

"You go on to the actual outsourcing and you end up in a total mess. You define the services required in one way, they define it in a different way"

Weinbrom was more than happy to talk about AT&T's ability to do just that. "We've looked at all those things and some of the products we have today are really opportunities where you can make a trade-off between spending your own capital or spending AT&T's capital," he said.

Up in the Cloud

One of those products is cloud computing. Graham Ford, General Manager, Finance Services Operations at Fuji Xerox, said that his company has embarked on a "study approach" to the cloud, starting with travel expenses management. "Just to try, just to experience," he explained. So far the experience "has been fine."

"For us it was a conscious decision to [use a cloud solution for] some things that are not so sensitive and which requires specialist expertise that we don't have," he added. "There are other processes we can put on the cloud, but we'll take it step by step. But definitely we're not going to put our GL [general ledger] out there."

Indeed, there were quite a number of processes that some roundtable participants indicated they would not put on the cloud or outsource to third parties. One simple test, said another participant, is to ask yourself what the process is meant to do.

"Things that are required to keep the lights on could be turned into

Singh, Jun Tu of Pepsico and Choo Hock Lye of AT&T

From left: AT&T's Fung, Chia Chey Hui of Philips, Foo Fei Voon of Sembcorp and Bacani of CFO Innovation

opex, but things that drive the strategy and value of the business, you have to think twice. Is it a key driver of organic growth? Does it add value to the service you provide your customers?

Said this participant: "Generally my preference would be to keep these things [the strategy value drivers] in-house, but to see if some elements can be outsourced. Not the entire basket."

When it comes to cloud computing, said another participant, there's no way around the ultimate decision of taking a leap of faith. "At some point, you have to say, OK, I trust that someone else is going to take care of my data, even though at the end of the day, my customer is going to call me and not [the cloud computing provider] if there is a problem."

Outsourcing Blues

The same dynamic is at work – and even more so – in third-party outsourcing, which is another way of turning capex into opex. "I think outsourcing is the much better model," one participant opined. "But the key is how you manage the whole thing. After the clock has started ticking, then the surprises come."

His experience is instructive. The company hired a top-notch consultant to advise on which service provider to employ. "Then you go on to the actual outsourcing and you end up in a total mess," this participant said. "You define the services required in one way, they define it in a different way."

"We have a hundred-plus ERP systems and 85 data centres. Do you fix them yourself or do you let someone else fix them?"

Another participant shared his company's own experience with outsourcing. "At times, we're guilty of saying, Oh, those guys..." he admitted. "It's too easy when you hit the first problem to say, They don't really have my company's best interests in mind. But there are always surprises, even when you do things in-house."

The best approach is to avoid making the relationship "an us-against-them thing," he said. "You have to go into it almost like a marriage. What you really need to say is, Let's work on this. Our [outsourcing] partners really want us, they want us to renew the contract, they want to use us as reference. Those are the same things we want from our own customers."

"The gains do not necessarily have to do only with savings. When launching expensive projects, opting for opex rather than capex gives the company the flexibility to pull the plug"

Another participant said that his company was in the early stages of the process of finalizing an outsourcing agreement as part of a major transformation of finance and IT. "In the presentation, [the service provider] said 35% to 40% in savings is possible," he recounted. "We wanted this to be written into the contract so that there was clear understanding on what was included in the scope [of the service] and what was not. The service providers were quite open to this and highlighted that it is a two-way process in order for both parties to benefit from the proposed relationship."

While the contract has yet to be finalized, the discussions so far has been encouraging, including "future pricing strategies that are proposed to be shared amongst the two parties," said this participant. "One of the key lessons learnt so far is about SLAs [service level agreements]. You need to have a clear understanding on the scope and honour your commitments agreed as part of the relationship for you to deliver the expected results."

At Philips, said CFO Chia, "we tend to do shared services in-house first, and outsource after the processes are stabilized. We've done this with IT, we've done this with finance."

From left: Foo, Bacani, Umesh Shah of Unilever and Edmund Mah of Keppel

From left:
Emmanuel Walter of Alstom, Weinbrom and Singh

She cautioned, however, against expecting too much cost savings from outsourcing. "Normally in this part of the world [Asia], companies might not see much cost benefit [from lower expenses] because labour cost is low here." A company paying high Hong Kong wages may benefit from outsourcing to lower wage countries such as China, India, Malaysia or the Philippines. But a company in China outsourcing to India will not see much in terms of lower labour costs.

The real gains, said a participant, comes from having an expert take care of functions that are outside the company's competence. "We have a hundred-plus ERP systems and 85 data centres," he said. "Do you fix them yourself or do you let someone else fix them? In our case, we said, We're not experts. We won't get it right. Someone already has a process that's working. By using them, we can focus on what we do best."

Telepresence

Another area where capex can be turned into opex is telepresence conferencing. "So far, it has been good for us," said Jun Tu, CFO at Pepsico Foods (China) in Shanghai. "You can be in New York in the morning and Dubai in the evening – all without leaving the office. It's almost real experience, face-to-face experience. It does fulfil its promises."

Pepsico has built telepresence rooms in its offices around the world, including China. "Ours is capex," Jun Tu explained. It is therefore important to maximize usage of the 24/7 facilities. "You have to make sure you're using it all the time." The downside is that people don't think twice about arranging a meeting on weekends and after-office hours. "But the ROI is pretty good," he said.

Companies have the option to make telepresence facilities, which can cost millions of dollars to build, an opex solution, rather than capex. For example, AT&T can provide an end-to-end solution including equipment, and then can charge the company a monthly fee. AT&T retains ownership of the telepresence equipment, which is sited in the client's premises.

"Another option is for the client to buy its own equipment and we install and maintain it for them," said Audrey Fung, CFO, AP Region, at AT&T Asia/Pacific Group. There are also AT&T telepresence rooms in business centres and hotels.

How much will it cost? For a recent three-hour meeting in Dallas, AT&T spent US$850 per person on airline tickets, hotel and other expenses. There were five executives who flew out for the meeting, so total expenses came to US$4,250. There are 260,000 AT&T employees, a fair number of whom travel for face-to-face meetings. "If we can save ten of those meetings a week, let's call it at US$200,000, that's US$2 million in savings a year," Weinbrom estimated.

One participant said her company was looking at telepresence seriously. "I would like somebody to invest in these rooms without me having to pay for it," she said. "But our offices are not in the major cities. If we are in a second-tier city in China, for example, our office will be in the outskirts. I'm not sure it is workable to have a telepresence room in remote areas."

Conclusion

There are many persuasive reasons for companies to explore turning capex into opex. The potential of reaping substantial savings is an obvious one, particularly from the use of telepresence rooms. Add the benefits of not having to spend so much time at the airport, on the plane and on the road, along with jetlag and the toll on people's energies, and the appeal of telepresence for the participants in this roundtable becomes understandable.

One size does not fit all, however. While an opex solution may require lighter expenditures at the outset, the company will need to continue paying those costs year after year. Capex spending may be heavy and front-loaded, but the payments end after a certain period and the company can deduct depreciation charges in its income statements.

Graham Ford of Fuji Xerox and Walter

But as many participants in this roundtable pointed out, the gains do not necessarily have to do only with savings. When launching expensive projects, opting for opex rather than capex gives the company the flexibility to pull the plug if there is a danger that the expected returns would not materialise. It is much harder to bite the bullet when hefty capital expenditures have already been made.

Cloud computing, outsourcing and telepresence are some of the ways open to companies in turning capex into opex. As in most things, adopting these strategies brings new challenges as well as opportunities, including the risk of partners not delivering on their promises.

When done right, however, contracting out non-core competencies and elements of core processes not only saves money, but equally important, helps optimize the company's operations and strengthen the bottom line.

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