IDC ANALYZE THE FUTURE

Executive Summary

Financial Impacts of Accelerating Server Replacement Cycles

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Introduction

IDC research found that more than 50% of organizations replace their servers after five years or more. These long replacement cycles decrease employee productivity and increase both unplanned downtime and IT staff time spent on compliance and maintenance. While these indirect costs are discreet, they can accumulate quickly, negatively impacting an organization's profit and loss (P&L) statement. In addition, long replacement cycles constrain innovation, inhibiting the digital transformation process that is necessary for maintaining a competitive advantage. To reduce server infrastructure costs and prepare for the digitalized future, IDC recommends that CIOs and IT leaders prioritize the upkeep of on-premises servers specifically by adopting more frequent replacement cycles that will help optimize their server performance.

The Depreciation of IT Server Infrastructure

Organizations view new servers as financial assets. Over the useful (financial) life of the server, the purchase price of the server is expensed (i.e., depreciated in increments over time) to the IT budget.

Adjusting to a Shorter Replacement Cycle

Shorter, three-year server replacement cycles can increase the annual depreciation expense charged to IT. As a result, IT should anticipate an adjustment period when transitioning to a shorter server replacement cycle. When organizations replace an existing server sooner than planned, the remaining book value (the undepreciated value) of the old server needs to be expensed. The new annual depreciation expense will be higher because servers will be replaced at a faster rate. This can inflate the P&L impact of asset depreciation in the first year. In subsequent years, the depreciation charge may stabilize, but remain higher than in previous years.

Offset Increased Costs with Efficient Investments

Finance and accounting departments generally defer to IT in managing resources and expenses. When IT becomes more productive and efficient, the savings will not show up on the P&L unless IT can reduce hard costs such as headcount, equipment, and operating expenses. Because of this, CIOs and IT decision makers typically see long replacement cycles as financially beneficial for both the IT department and the business. Delaying server replacements means postponing any new costs associated with the procurement of servers. More specifically, long replacement cycles appear to increase the amount of IT spend available for other initiatives. However, aging infrastructure costs IT disproportionately more than new infrastructure. This cost difference accelerates after year four.

IDC research indicates that shortening the server replacement cycle from six years to three years results in annual operating cost savings of 200% per server. Contributing to this cost savings is the reduction in IT support requirements needed per server. For example, on average, organizations reporting longer replacement cycles of six years or more allocate 16 IT staff hours per week, per server. Comparatively, this number decreases to 14 hours for organizations reporting shorter three-year replacement cycles. These efficiency savings often do not translate into dollar savings, so it is difficult to account for them in the IT budget.

Infrastructure Investments Generate a Return for the Business

For many organizations, digital transformation increases the share of revenue directly generated by IT operations. As a result, companies begin to view IT as a strategic product with an informal P&L rather than as a cost to be managed. Industry leaders that acknowledge this will be in a better position to measure the effectiveness of IT investments as they would other business opportunities. By developing trusted partnerships with IT vendors that act as extensions of their IT departments, organizations can become better equipped to measure the drivers influencing the return on IT capital and determine the optimal replacement cycle for their server infrastructure.

Treating IT as an asset means distinguishing between growth and maintenance capital. Profitable and efficient growth capital generates a future return. In comparison, maintenance capital encompasses operating and upkeep expenses accrued over the life of hardware. Organizations that properly balance their growth and maintenance capital can achieve an optimized cost-per-performance server environment.

Growth and maintenance capital should not be thought of as two separate concepts. Instead, capital should be considered as a continuum, with growth capital (young servers) slowly transitioning to maintenance capital (older servers). For example, immediately following a server replacement, organizations experience less unplanned downtime and increased customer satisfaction and retention. Additionally, organizations report increased IT spend for innovation as compared with maintenance. Around the four-year mark, this growth capital begins to turn into maintenance capital. The hardware begins to age relative to current applications, customers begin to sour on the digital experience, and IT finds itself dedicating more staff to IT maintenance and compliance issues.

Optimal server replacement cycles reduce the direct and indirect costs of aging infrastructure. The result is more resources that can be allocated for IT innovation and automation opportunities.

As server infrastructure ages and the business digitizes, IT becomes a revenue-generating product. Industry leaders that value their server infrastructure as a strategic asset should consider measuring it as such. Distinguishing between growth and maintenance capital puts IT expenditures in the context of the company's broader digital transformation. By framing the server replacement cycle within the context of growth capital, IT can act as a growth engine for the company.

Related Research

To see the data and read the in-depth analysis of the impact that a timely server replacement cycle has on organizations, download the **midsize-focused** or **large enterprise-focused** white paper.

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