Perspective

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Flex IT Cost, and Drive Business Value
A Memo to the Chief Information Officer

Traditional IT cost reduction methods alone are not powerful or sustainable enough to respond to this recession. CIOs also need to address the structural components of the IT cost base and align IT more closely to the business by creating more flexible and adaptive cost structures. Successful CIOs will aggressively attack total and fixed costs, while partnering with business leaders to place smart bets on new technology and capabilities that are affordable today, will drive near-term profitability, and offer a payback period of 18 months or less.

A MORE EFFECTIVE RECESSION AGENDA

With the recession spurring a major contraction in spending, companies—particularly in hard-hit sectors such as financial services and manufacturing—are turning to their chief information officers to contribute cost reductions of 20 percent or more. The CIOs who respond most effectively to these demands will adopt a comprehensive approach that uses cost variabilization to achieve substantial, enduring cost reduction and fund business value creation.

Most CIOs have already pursued all the traditional cost-cutting responses to downturns—deferring investments, freezing hiring, cutting contractors, renegotiating vendor contracts, consolidating systems, and curtailing travel, training, and administrative spending. But these measures will not suffice in the current recession for three reasons:

- This recession will last longer and cut deeper than any downturn in the tenures of today's CIOs. Historically, IT costs tend to contract at two to four times the contraction in the GDP rate, increasing the cost-cutting challenge.

- As technology has become more integrated into core business processes, IT spending has grown apace—nearly 30 percent faster than GDP (Goldman Sachs, November 2008). At the same time, today's IT departments are less prone to waste money and much leaner than in the past.

- Traditional IT cost reduction responses focus on capital expenditures and discretionary spending. But, at present, these actions encompass only 30 percent of IT's cost structure. Fully 70 percent of IT expenditures reside in fixed operating costs, which only 21 percent of CIOs are targeting for substantive reductions in this recession (Forrester Research, December 2008).

These conditions suggest that CIOs must pursue a more systemic and balanced recession agenda. They must still aggressively cut discretionary spending. But they must also variabilize fixed costs—aligning IT capacity and spend in ways that are sensitive to continuously changing volume and service levels. They must fund ongoing and new initiatives that position their companies for recovery and return cash to the business. And they must recognize that their enterprise-wide purview offers a leadership platform for partnering with their business unit colleagues to discover innovative ways to streamline processes, improve business performance, and create new revenue streams.

Aggressively attack IT costs without damaging capabilities. To the extent that CIOs can quickly wring out costs associated with tactical low-value activities and discretionary spending, they should. But they should avoid reflexively cutting costs along budget lines and killing ongoing projects without due consideration.

Syndicating cost reductions often harms the business by cutting too deeply in some areas and not deeply enough in others. Summarily halting technology enablement projects can also have adverse and unintended

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effects, such as forcing costs back into business units, delaying the return of cash, and undermining revenue enhancement opportunities. During the last downturn and in the midst of integrating an acquisition, a large energy company froze all IT process enablement projects. The result: Business support costs rose, eroding more than 80 percent of the projected synergies within three years.

Identifying where to cut costs, where to hold the line, and where to invest is especially important. To get it right, CIOs should consider how the recession has impacted business priorities. Then they should rebalance and prioritize current IT investments and capital expenditures with an emphasis on clear business value, quick payback, and acceptable risks. Most important, they should define a cost-cutting and investment-decision framework that addresses fixed costs—the area with the greatest potential for large, sustainable spending cuts.

The best lever for these reductions is variabilizing costs. This recession offers a valuable opportunity to better align cost with demand and reduce the fixed component of the cost base, especially in areas such as applications development and maintenance, data centers, and service desks. Toward this end, CIOs should carefully evaluate technology and processes that support variabilized costs, such as software as a service, capacity-on-demand, and cloud computing. They should also implement tiered service levels and more flexible and value-based demand management processes; make changes to their IT operating model; and shift their resourcing, compensation, and incentive plans toward a more variable model. Further, outsourcing contracts should be structured on a pay-on-demand basis.

By aligning IT more closely to the business using variable costs, CIOs can cut into the heart of their cost structure, while improving the efficiency of IT and boosting the flexibility of the business. These benefits will pay dividends no matter how the economy behaves.

Deliver value to the business with smart, affordable bets. This recession has placed another opportunity within the grasp of CIOs: the chance to extend their leadership across the business and deliver on IT's potential as one of a company's best sources of value. CIOs who seize this opportunity can use IT's boundary-crossing nature to simplify business processes, drive new business models, improve productivity and supplier collaboration, and gain new customer insights.

They will accomplish this by making smart bets with process and technology investments that provide a payback in 18 months or less. This is not the right time to recommend big, complicated programs with long lead times and distant paybacks. But with recession-driven pressures building across companies, this is an excellent time for CIOs to identify areas and acceptable trade-offs in which significant improvements are possible. Now is the time for the CIO's voice to be heard because the recession has created an urgent need for value-creating ideas with fast paybacks.

The most promising inflection points for such ideas will vary across industries, but they exist in every company. One consumer bank is currently using technology to produce new revenue and reduce the cost to serve customers by enhancing its direct channels to market. These enhancements allow the bank to acquire new customers, to direct customers to more cost-effective channels, and to up-sell and cross-sell products and services. In the energy sector, one company is tapping into its maintenance databases to improve transparency and productivity in its core operating processes. The project enhances the productivity of the internal engineering staff and reduces the need for expensive, labor-intensive support. Both projects feature moderate costs and fast, quantifiable paybacks.

To execute this recession agenda, the most successful CIOs will think about their role and the scope of their function in new ways. They will first use this opportunity to overhaul their cost structure. Then, recognizing that technology is the lifeblood of many companies and that CIOs know the best ways to leverage it, they will act as business leaders in addition to functional leaders, and partner and collaborate to release cash and enhance revenue throughout the company. Those CIOs who embrace these principles and become catalysts for change will be highly effective drivers of enterprise-wide cost reduction and value enhancement during this recession and long afterward.

For additional insight into the challenges of the current recession and practical advice for leading your function and company through it, please visit www.booz.com/recession.

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