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High-Performance IT
*Achieving Sustainable
Returns on IT
Investment*



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EXECUTIVE SUMMARY

During the past 12 months, IT expenditures have been the focal point for aggressive cost reduction programs across all industries. Most cost-cutting programs targeted short-term budget items in the IT project portfolio. In the process, ongoing initiatives were stripped down, implementation scope was reduced, and programs planned for the immediate future were put on ice. In addition, gains were sought through the short-sighted outsourcing of key IT processes. Sometimes companies outsourced critical aspects of their build and design activities that were perceived as overly expensive, trading away essential IT skills and proprietary technology in exchange for short-term cuts in direct costs.

Despite these steps, IT operating expenses—the amount required to run data centers, purchase and install desktops and laptops, maintain applications, and support users—have not diminished significantly in most cases. And although overall IT budgets took a bit of a hit, it was at the expense of the competitive advantage that IT innovation can be counted on to deliver.

There is a better strategy for reducing IT operational costs that will not diminish a company's ability to differentiate itself by the technology initiatives it embraces. It involves a holistic approach that carefully analyzes key aspects of supply and demand and how best to deliver IT hardware and software to satisfy the needs of the entire organization.

KEY HIGHLIGHTS:

- IT cost-cutting programs tend to look for short-term savings without sufficient analysis of the long-term impact.
- Companies often make the mistake of outsourcing essential IT building and design activities that are viewed as expensive, losing in the process the competitive edge gained from improving internal IT skills and developing proprietary technology.
- Three steps must be taken to properly reduce IT operational costs without minimizing the long-term competitive edge that IT can deliver: (1) improve supply/demand oversight, (2) minimize complexity in the application base, and (3) find the appropriate balance for insourcing and outsourcing.

IT SUPPLY AND DEMAND SYNCHRONI- ZATION

To permanently improve IT efficiency across all stages of the plan-build-run cycle without sacrificing long-term organizational performance or competitive position, chief information officers should explore three approaches: (1) better supply/demand synchronization as part of an optimization of IT governance, (2) active consolidation of the application base, and (3) finding the right balance between insourcing and outsourcing (*for a detailed methodology to analyze these three aspects of potential IT efficiency, see “360-Degree IT Benchmarking: A New Approach to an Old Problem,” page 6*).

IT organizational flowcharts have evolved organically over time, and their underlying structure differs depending on the business unit that the IT group works for. Some are organized along geographic segments, others by types of clients. And still others are organized by functions; the IT department involved with sales is different from the unit that works with manufacturing. Under this segmented structure, IT managers lack the muscle to dictate unpopular moves that could improve efficiency and save money—for example, refusing a business unit’s custom software request because an

off-the-shelf product is similar, let alone more robust. Moreover, as long as IT operations are segregated within business units, it is difficult to establish firm-wide IT standards that provide economies of scale, apply cross-business unit technology, allow an IT organization to efficiently shift staff between business units, outsource intelligently, and place the best talent and knowledge in the parts of the company where they are most needed.

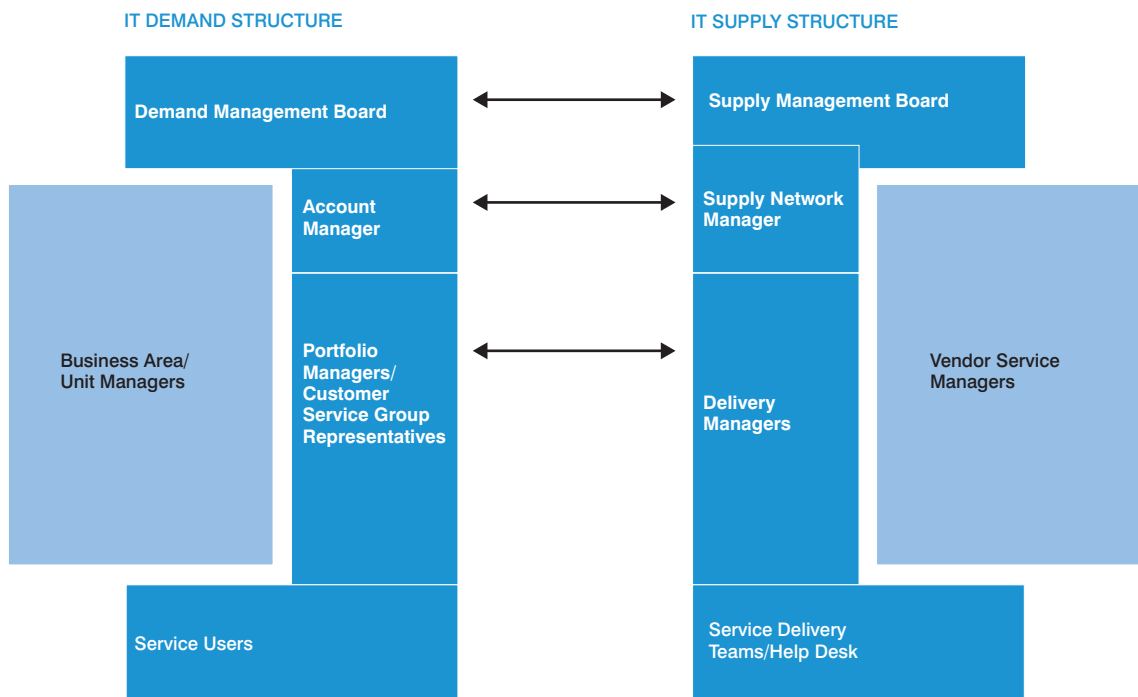
The solution to this IT organizational dilemma is not structural; it resides in other crucial but often overlooked governance levers. Organizations must set up a pair of skilled corporation-wide supervisory teams, including people from both the IT function and the business, to manage IT from the demand side and the supply side. Their

overriding purpose is to make determinations about IT investments based on the cost structure and strategic needs of the entire company, rather than merely on how the technology nuts and bolts fit together on the ground floor of IT operations (see *Exhibit 1*).

To achieve supply/demand synchronization, three IT governance bodies need to be installed in each supervisory team: a management board to deal with contractual relationships, commitments, and obligations and make recommendations regarding fundamental commodity versus specialty approaches; a supply network or account manager responsible for evaluating business needs for specific tasks; and delivery or portfolio managers to handle pipeline management on an operational level.

Those governance bodies must estimate the actual long-term cost of project requests early in the process—before the project is approved and initiated—and, based on this cost projection, calibrate requirements down to a feasible level for the organization. Also, they must give IT projects a green light only when they are certain that similar technology, hardware, or software does not already exist at the company. And finally, these boards of experts must ensure that approved projects fit the organization’s overall IT strategy and vision. Such a diligent IT supply/demand governance structure will not only improve the relationship between the business side and IT but also challenge, prioritize, and reframe the addressed strategic requirements of the organization.

Exhibit 1
Oversight Model for IT Demand and Supply



Source: Booz & Company

APPLICATION CONSOLIDATION

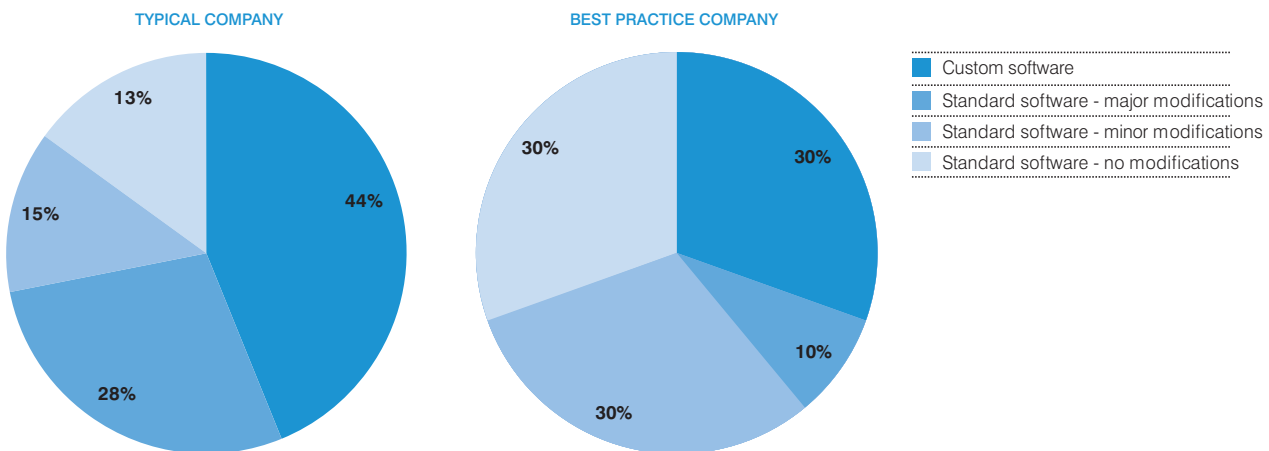
In the build phase, significant potential for sustainable improvement of IT efficiency lies in actively managing the application base. Continuously expanding business requirements have led to an increasingly complex internal application landscape with unchecked redundancies and limited transparency. Such a vast number of programs are exceedingly hard to manage and

expensive to build and maintain. Reducing application complexity and minimizing the number of business applications and individual software implementations in an organization can lead to a decrease in specialized service personnel, simplification of maintenance efforts, and fewer software release cycles requiring synchronization and management. Under ideal conditions, about half of the software should be standard and the customized programs should require few modifications (*see Exhibit 2*).

As the number of applications is reduced, the database management effort should become less cumbersome.

By centralizing software installations throughout the company, IT departments can relieve individual business units of the requirement to manage their own information trails. Such improved corporate process integration allows a company to maintain a single global master database of customers, vendors, materials, accounts, and the like, which can be distributed throughout the organization virtually in real time. By harmonizing data management, companies can enjoy reduced conversion and aggregation costs and lose fewer business opportunities through the inability to aggregate or access data in time.

Exhibit 2
Typical Company's Overly Complex Application Landscape



Source: Booz & Company

BALANCING INSOURCING AND OUTSOURCING

Smart sourcing and finding the right balance between reducing costs and preserving know-how and technological flexibility lead to sustainable improvements, particularly in build functions. Recent Booz & Company research found that many leading companies—after years of substantial cost reduction pressures—outsource significant parts of their IT without systematically thinking about which processes, services, and activities should be farmed out (*see Exhibit 3*).

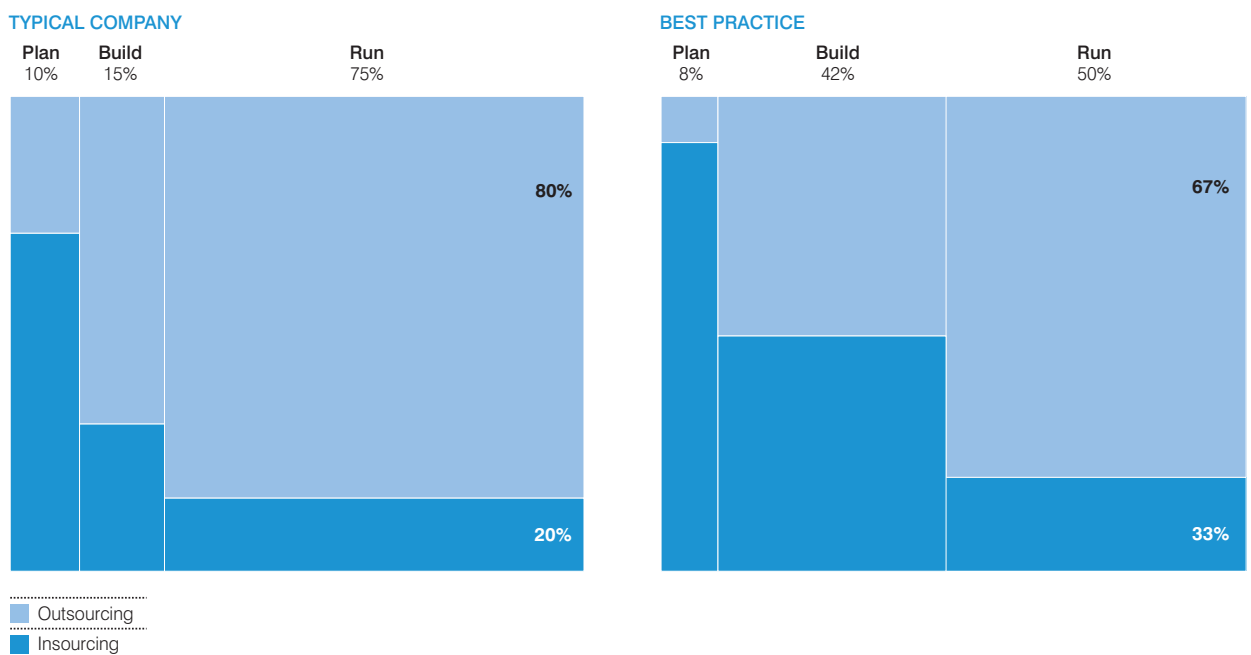
These companies often get tangled up in inflexible deals, in which specification changes are expensive and price decreases for hardware and software are not fully passed back, while being too unsure of their own IT cost structure to know that they are losing money in the process. Indeed, this can be an expensive oversight involving more than money. For one thing, by outsourcing too much, companies lose the know-how and technological flexibility to implement internal structural measures that can improve effectiveness and efficiency. Moreover, without

strong internal technological capabilities, a company's competitive edge can be threatened. In fact, some leading companies have realized this and are in the process of spending significant amounts of money to unwind poorly chosen outsourcing deals and bring critical parts of their IT operations back in house, often in hopes of both rebuilding talent and better utilizing idle network capacity.

Setting criteria for appropriate outsourcing is not an easy task. We found four points absolutely essential for a positive outsourcing decision:

- The process to be farmed out does not deliver a competitive advantage.
- The process is mature and stable
- The supplier has better economics.
- The company can manage risk and oversee the provider's operations.

Exhibit 3
Make-vs.-Buy along Plan/Build/Run Categories (costs as percentage of total IT budget)



Source: Booz & Company

360-Degree IT Benchmarking: A New Approach to an Old Problem

Traditional IT benchmarking suffers from a huge blind spot. Typically, IT organizations are benchmarked along operating cost categories in infrastructure and services and measured by how many projects they can deliver with limited resources of time and budget and by whether their customers are satisfied with their services. Criteria such as server unit cost, mainframe operational availability, and user help desk issue-resolution ratios are typical in these benchmarking exercises.

But those standards are not likely to produce lasting high performance. In the end, the assessment often reveals what was obvious in the first place, compares aspects of the IT organization that are not directly comparable, or is too myopic to disclose the deep-seated and larger flaws in IT operations. Such narrow benchmarking focuses almost completely on lowering immediate unit costs of operations and ignores the root causes of IT inefficiency, the fundamental issues that once addressed can help drive true structural and sustainable IT improvements.

For a more complete and much more valuable analysis, we recommend that companies adopt what we call 360-degree benchmarking methodology for the IT organization. Based on nine components, this modeling approach covers quantitative issues (for example, IT spend as a percentage of revenue) as well as qualitative issues (e.g., the maturity of IT processes). Using this tool, it is possible in a sophisticated, holistic way to compare a company's IT performance with that of its competitors and with best practices and to generate peer group and cross-industry rankings and comparisons (see *Exhibit A*). From those, an analysis can be generated that clearly illustrates areas where IT performance is on par with or below or above the average across industries.

To get a truly accurate picture of the performance of an IT organization, expenditures must be analyzed across the entire value chain, broken down by the cost of planning and building on the one hand and the cost of running the operation on the other. After the origins and drivers of these costs are analyzed with 360-degree benchmarking, expenses can be cut and efficiencies gained by tackling the fundamental aspects of the IT function that are responsible for the operational deficits.

Exhibit A
The 360-Degree IT Benchmark Program Examines All Relevant IT Areas

IT BENCHMARK ELEMENTS		INDUSTRY PEERS	CROSS-INDUSTRY BEST PRACTICE	QUALITATIVE	QUANTITATIVE
Strategic	Cost and Budgets	●	○	○	●
	Organization and Governance	●	●	●	○
	Performance Management	●	●	●	○
	Resource Allocation	●	●	○	●
Plan	Skill Management	●	●	●	●
	Process Maturity	●	●	●	○
Build	Application Landscape	●	○	●	●
	Project Portfolio	●	●	●	●
Run	Infrastructure and Services	●	●	●	●

Source: Booz & Company

CONCLUSION

CIOs must more deeply explore structural IT efficiency measures that could improve performance and reduce cost levels across the entire value chain of their organizations. Relying on short-sighted benchmarking and traditional budget-trimming approaches only kicks the problem down the road and worsens the potential outcome, par-

ticularly when applied to plan/build functions. Traditional benchmarking is an important first step to evaluating IT operations. But to substantially increase the value that IT brings to the organization and achieve sustainable cost advantage, IT leaders must more proactively and intelligently manage their operations.

CIOs must more deeply explore structural IT efficiency measures that could improve performance and reduce cost levels across the entire value chain of their organizations.

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