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Kiss and Make Up *Industrial Manufacturers Need to Patch Up Relationships with Their IT Organizations*

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Kiss and Make Up

Industrial Manufacturers Need to Patch Up Relationships with Their IT Organizations

The IT organization within manufacturing often finds itself caught between opposing imperatives, both encouraged to provide greater support to the business and ordered to cut costs. In response, some IT organizations have achieved a step change in performance, delivering higher value to the business with a cost structure approaching 1 percent of revenue. An IT organization that can transform its operating model to act as both cost center and strategic enabler will be poised to manage both the cyclical nature of the present and the growth needs of the future. In doing so, they will be able to mend the occasionally strained relationships that have developed between IT and the business.

Changes for Industrial Manufacturers Mean Tough Times for IT

The last few years have been anything but ordinary for industrial manufacturers, with competition from China pounding on price points and sharply higher input prices for commodities chipping away at margins. The domestic agenda has weakened, demand in the emerging markets is driving organizational priorities, and capital investment has shifted geographies to

follow the customer. The organization has redistributed its talent globally to the new footprint, rising stars are overseas. Innovation is tapped as the crucial capability for growth.

The tumultuous result? A spectacular transformation has occurred for industrial manufacturing: Organizations have been forced to change their model across almost every strategic dimension in order to compete, if not survive.

The IT organization has been caught squarely in the middle of this maelstrom, thrashed by two opposing dynamics. As industrial manufacturing undergoes globalization and consolidation, technology plays a growing role in driving product and business model innovation—ergo, IT must grow. In the same breath, cost pressures make the relatively large IT spend base an easy target for aggressive, cost-rebalancing actions—leading IT to shrink.

This constant push-pull of interests has generated a vicious cycle for IT. First, manufacturers make spending cuts a priority, cut service levels to the bone, and put capability in the back seat to achieve targets. Next, the business reaffirms the value of IT and infuses cash to grease the squeakiest wheels (which may not be the most critical). Over time, IT budgets appear inflated once again and the drumbeat for cost reduction renews.

This harsh sequence of events predictably leaves the IT organization short on capability, de-motivated, and under-equipped to deliver on the strategic agenda of the business. Worse yet, sometimes IT can be a constraint, unable to move fast enough on critical imperatives such as scaling globally or driving innovation, causing the business to seek its own localized resources to do the work. In the end, IT struggles to prove its value, even in cases when it has, in fact, added value.

The 1 Percent IT Organization

But IT can break out of this vicious cycle. Recently, we have seen IT organizations in the industrial sector achieve a step change in performance, delivering higher value to the business with an efficient cost structure approaching 1 percent of revenue, in contrast with many IT organizations in this sector, which average a cost structure of 3 to 4 percent of revenue. These organizations have implemented a new, best-practice operating model **that we call the 1 percent IT organization**, which achieves an optimal balance of cost and capability to drive superior performance.

Becoming a 1 percent IT organization cannot be done in a business-as-usual manner; rather, the 1 percent IT organization *transforms its operating model to act as both cost center and strategic enabler*, poised to manage both the cyclicity of the present and the growth needs of the future.

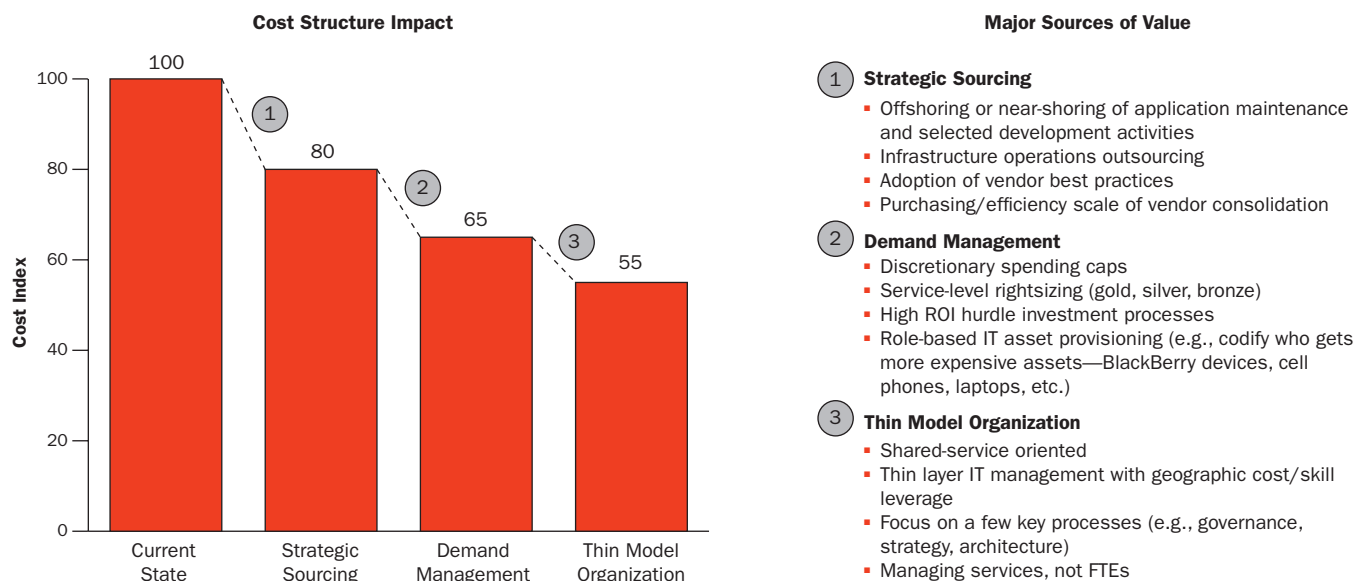
The design objectives for the 1 percent IT organization are clear:

- Radically reduce the costs for “running the business” to free up funds for innovation.
- Restructure the organization to retain only core, value-added capabilities, such as vendor management and enterprise architecture, and leverage the strengths and efficiencies of the IT market to deliver non-core services.
- Make the IT function variable, providing transparency in costs, service levels, and performance such that the business can make informed choices.

Most important, meet these goals while maintaining a more affordable cost structure, near 1 percent of revenue.

Exhibit 1

1 Percent Transformation Program Components and Sources of Value



Source: Booz Allen Hamilton

Easier Said than Done

Most IT organizations adopt these objectives selectively, not comprehensively, and thus fail in the journey. Usually they try a piecemeal approach, targeting spend cuts or capability levels blindly, under pressure from corporate directives. This method is tantamount to organizational suicide, typically depressing service levels and crippling the relationship with the business. Too frequently, the end profile is an IT function perpetually engaged in course-corrective programs to regain trust.

Operating model change does not come easily: The transformation is difficult and working incrementally does not work. In our experience, best practices dictate that the 1 percent IT organization embark on a holistic program to reinvent its operating model, integrating three major components: strategic sourcing,

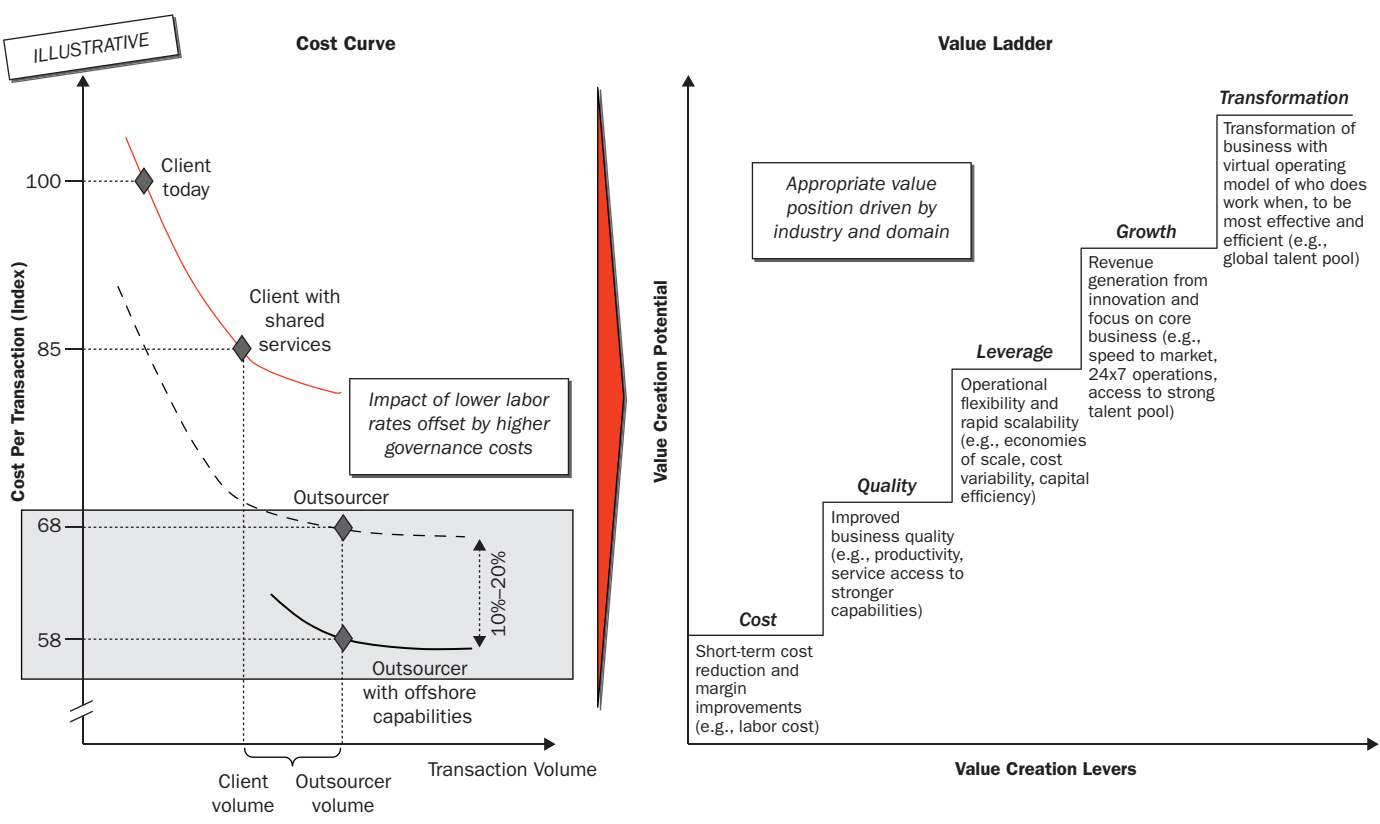
demand management, and a thin model IT organization (see Exhibit 1).

Transformation Component #1: The 1 percent IT organization selects the right strategic sourcing strategy for its business.

In our experience, one size does not fit all. The right strategic sourcing strategy mixes strong internal talent with appropriate capabilities from the service provider. Strategic sourcing of IT services is a proven cost-reduction play. The art, however, is in understanding with whom to partner, where to drive value, and how to manage the relationship—variables that have different answers depending on the context (see Exhibit 2).

Too often, IT organizations outsource to cut costs and realize some early savings benefits, but struggle to find value beyond the initial deal. A typical scenario:

Exhibit 2
IT Strategic Sourcing Cost Curve and Value Ladder



¹ Duke University/Archstone Consulting Offshoring Research Network 2004 and 2005 Surveys and Duke University/Booz Allen Hamilton Offshoring Research Network 2006 Survey
Source: Booz Allen Hamilton

The IT organization demands favorable pricing to show quick savings and the outsourcer provides low fixed rates to enter into the deal, but marks up margins in subsequent project/change work to recover costs. Not surprisingly, incentives for continuous improvement plummet, talent is poached by the provider to handle new opportunities, and an adversarial relationship ensues between customer and provider.

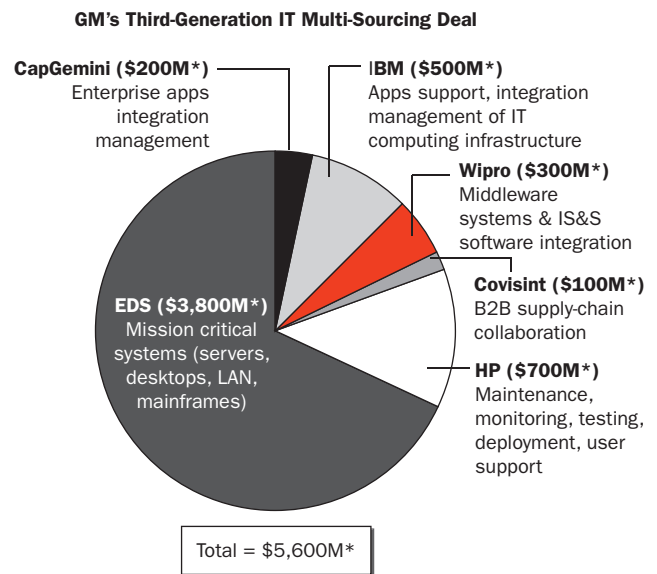
By contrast, the 1 percent IT organization structures its relationships with a long-term view in mind. It recognizes that outsourced service providers need to be strategic partners, not just body shops, and uses an incentive-based, performance-driven model to capture ongoing value. The IT organization and the provider agree upon a clear set of delivery and continuous-improvement metrics, such that gains are accrued to both parties: This provides a transparent set of motivators to the strategic partner to drive value into the relationship in a systematic, ongoing manner. In addition, the governance mechanism, metrics, and processes to manage the relationship are rigorously codeveloped, with shared accountability for results.

The result is an IT organization more adroit when it comes to strategic sourcing. It can effectively dial down (e.g., plug in a vendor for low-cost commodity services), dial up (e.g., partner opportunistically for access to innovation and global talent), or say no altogether when prudent. This finesse provides tremendous flexibility, but also requires strong capabilities in demand management and vendor governance, overseeing both the pipeline of work and matching it to the appropriate supply resources. This drives the need for a different type of IT manager—one who can manage service providers to the right balance of cost and capability and “see the forest for the trees” to leverage innovation where it counts.

Manufacturers can realize bigger benefits over time. When GM announced its third-generation IT strategic sourcing deal in 2006, the company opted to spread

Exhibit 3

GM takes advantage of robust strategic sourcing capabilities



* 5-year TOV
Source: Booz Allen Hamilton

its \$15 billion budget across a number of providers—EDS, HP, IBM, CapGemini, Covisint, and Wipro (see Exhibit 3). This allowed GM to leverage offshore pure plays for more discrete, commoditized services and strategic talent for higher, value-added areas. It did not translate to a diminished role for internal talent; rather, GM made senior IT managers responsible for global service delivery, managing the integration and accountabilities of these different vendors. As a result of the deal, GM dramatically reduced its cost structure and improved on quality and cycle time. The takeaway: the more robust your strategic sourcing capabilities, the more you can tailor the fit to your needs.

Transformation Component #2: The 1 percent IT organization builds a strong demand management capability to align priorities with the business.

The prevailing state of IT demand management takes on one of two forms: unregulated or poorly regulated. In the former, IT is viewed as a “free good” and consumption reigns. Projects are resourced despite

the lack of a clearly defined business case or scope. The delivery system gets completely clogged with unchecked demand. Speed to market is lost, as lower-value projects consume resources at the expense of initiatives with higher ROI. As a result, IT is perceived as slow, with misaligned priorities.

The poorly regulated scenario, where most industrials find themselves, is sometimes even worse. Multiple governance forums and steering committees exist with no one entity to aggregate demand. Small programs tend to “latch on” to higher-visibility programs to gain priority. If one governance body rejects a project, the project managers appeal to others. Multiple demand sources, all categorized as priorities, overwhelm available capacity. In the end, IT can be perceived as overly bureaucratic—in addition to being slow, with misaligned priorities.

The 1 percent IT organization, by contrast, has a strong demand management capability, built on four integrated pillars: processes, performance measures, tools, and accountability (see Exhibit 4). Demand is effectively categorized, prioritized, and prosecuted at an enterprise level. Communication and transparency are foundational; informed debate serves to align the agenda between IT and the business. Senior IT managers aligned with different domains, such as manufacturing and supply chain, offer their perspective on what those functions need and ensure that there is a rigorous process in place for making those requests. Gated funding and approval processes ensure that IT pursues only the highest-value projects.

In addition, a strong demand management capability has a further benefit: cost savings. In fact, demand management can generate significant savings, as

Exhibit 4
Demand Management Best Practices for the 1 Percent IT Organization

Framework	Typical Operating Condition	The 1% IT Organization
I. Processes	<ul style="list-style-type: none"> Varied processes by OpCo, governance forum, steering committee, and project phase Portfolio management confined to OpCo or steering committee levels and not widely communicated Limited visibility over major initiative pipeline and short-term resource planning 	<ul style="list-style-type: none"> Standardized processes for each project phase from demand capture to post-implementation review Active portfolio management at both the OpCo and enterprise levels Thorough communication of major initiative forecasting to facilitate long-term resource planning Rapid approval process for critical initiatives
II. Performance Measures	<ul style="list-style-type: none"> Inconsistent use of or lack of performance measures Limited use of SLAs, project scoring mechanisms, and project phase reviews 	<ul style="list-style-type: none"> Standardized performance measures for resource base and demand Scorecard views, standardized business cases, and standardized performance reviews at each project milestone Rewards for joint Business/IT success
III. Portfolio & Project Management Tools	<ul style="list-style-type: none"> Need for standard tools within and across OpCos Lack of a cross-enterprise project view throughout the project life cycle No linkage between incoming/forecasted demand and resource capacity 	<ul style="list-style-type: none"> Standardized tools for each step of the project life cycle Integration of tools to provide an enterprise view and monitoring capability Demand/supply balance facilitated by cross-enterprise tracking mechanisms
IV. Accountability	<ul style="list-style-type: none"> No ultimate senior management level authority Tiered decision structure consisting of disjointed governance forums with little collaboration Emergence of steering committees with executive sponsorship as stand-alone governance forums Unclear project paths and ownership 	<ul style="list-style-type: none"> Ultimate authority of one forum Tiered decision structure that spans from corporate strategy level to implementation level Collaboration between governance structures Clearly defined decision rights and accountability

Source: Booz Allen Hamilton

much as any supply or efficiency opportunity. The 1 percent IT organization uses four “quick hit” initiatives to deliver payback in less than a year and drop savings to the bottom line: “Turning off the spigot” to control discretionary spend; weeding out discretionary spend in the run budget; adjusting service levels to fit-for-purpose requirements; and instituting a provisioning model that codifies and enforces requirements for expensive digital assets such as BlackBerry devices and cell phones.

Some of these savings can be had in surprisingly easy fashion. One auto OEM found that up to 20 percent of the activity considered “lights on” work was actually project-related. By simply tightening up governance on day-to-day demand, it saved approximately \$25 million by stripping out this project activity and prioritizing it through the proper channels. The best part is how quickly these savings materialize—in this case, opportunity identification to policy implementation in less than three months. This kind of quick win dramatically bolsters the value of the 1 percent program in the eyes of the rest of the organization.

And there are bigger fish to be had. Over time, the 1 percent IT organization uses the demand management capability to work with the business on a standardization goal: common processes and common systems. This is not a one-size-fits-all exercise: A few “templates” per process act as the typical starting points, with variations to accommodate points of competitive or regional differentiation. This push for global practices (where practical) drives out complexity and delivers the dual benefits of reduced IT costs and speed to the market for integrating acquisitions or separating divestitures.

Overall, a strong demand management function delivers many benefits, but one key contribution is probably most gratifying: resurrecting the IT image. With a strong demand management capability, IT goes from being out of step with the agenda to being an

important player in the thinking on both innovation and standardization—a powerful and necessary retooling for the function as it works with the business on new priorities.

Transformation Component #3: The 1 percent IT organization uses a thin model organization to run IT as a business.

The 1 percent IT organization has a singular mission: delivering high-value services at best-in-class costs. That means building core capabilities, moving noncore work outside the organization, and making every activity leaner—all with a thin layer managerial structure. This drives some significant changes across the operating model, from supplier responsibilities (strategic sourcing) to business client behaviors (demand management). However, the most dynamic change is closest to the organization: IT management and staffing.

The 1 percent IT organization looks a lot different from the typical IT organization; namely, it is largely staffed in expertise-based functions (e.g., IT strategy, architecture, demand management, vendor management) versus utility-based roles (e.g., help-desk support, application maintenance). The proper governance, rules, and processes are put in place to ensure work gets done with a much smaller internal resource footprint.

This causes a dramatic shift in IT thinking. In the typical IT organization, most of the staff activity is directed to these utility-based roles. Consequently, most of the IT executive attention is placed on these transactional elements. With the transformation to more expertise-based roles, IT executive focus also shifts to more strategic, customer-centric interests. In turn, IT managers also develop a more forward-looking focus, taking on the roles of business enablers. A trickle-down effect occurs in the organization: Priorities shift from operational, day-to-day firefighting to driving value for the customer.

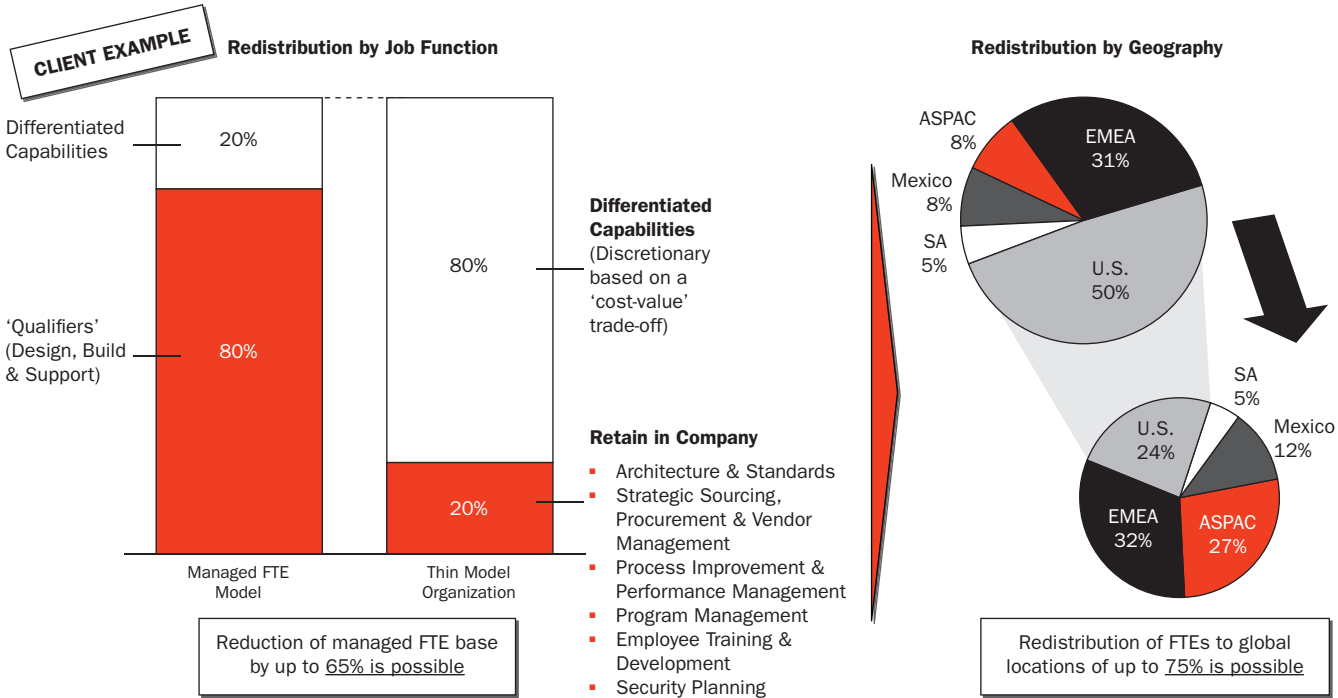
But a change in mind-set alone does not create closer ties to divisions and regions; key capabilities are required. The 1 percent IT organization creates customer account groups to understand key differences in support needs and innovation requirements by segment. These teams are responsible for maximizing the business value of IT, such that their segments can make informed choices on service levels, performance expectations, and the costs and benefits of their initiatives. Financial transparency, delivery metrics, and satisfaction audits serve to steer the relationship. Initially, this new dynamic can be uncomfortable for both sides. However, a clear metamorphosis takes place over time: The business appreciates the transparency and IT's role as trusted partner naturally evolves. Moreover, the change is rooted in lower levels of the organization, setting up the platform for closer collaboration in the future.

This paradigm shift drives the need for a different type of IT talent, requiring individuals who are equally

technologically savvy and customer-aware. For mature, established technologies, seasoned managers who can handle large solution vendors or service providers are ideal. These managers drive delivery through well-defined supplier-management metrics (e.g., SLAs, benchmarked prices, scalable cost/capacity) and vigilantly look for opportunities to lower costs through process standardization or technology refresh, as the case warrants.

For newer technology areas that drive the innovation agenda, the 1 percent IT organization looks for managers with a product-management mind-set—specifically, forward thinkers who can gauge the market, comfortably straddle the business-IT boundary to push the innovation envelope, and navigate ambiguous areas with instinct and confidence. These are not common skill sets within industrial IT organizations; it is worthwhile to seek out talent within the software industry, where this thinking is more prevalent.

Exhibit 5
Redistribution of Organizational Roles and Locations in the 1 Percent IT Thin Model Transformation



Source: Booz Allen Hamilton

Another key difference in the 1 percent IT organization is that in many cases, these roles are placed in global growth regions, such as Eastern Europe, China, and India, to get closer to business decision makers and customers. This is a notable deviation from the typical insular, headquarter-centric IT organization. This rebalancing is vital as these regions now represent the business agenda, and top IT talent needs to be close to the action to accommodate and direct the vision as needed. Correctly implemented, the new operating model radically reduces and redistributes the IT organization's talent and footprint (see Exhibit 5, page 7).

Conclusion

Where to begin such an enormous transformation?
As with all great endeavors, with one small step.
We find that the best way to start the 1 percent IT transformation is through a scoping exercise, a 10- to 16-week effort that defines the compelling need to

act in a manner that all stakeholders can understand. This is rooted in a fact-based assessment of current performance with a purposeful output—a definition of the new operating model, what needs to change, and the high-level business case and road map to get there. The detail design and implementation is done by delivery teams that carve out their domain-specific opportunities and drive them to completion. In all of this, the 1 percent IT transformation is structured to be self-funding and value-additive, such that cost savings finance the program and capability is regularly integrated into the organization.

We see the 1 percent transformation as the only way to break out of the cyclical funk of cost cutting and course correcting for IT. The journey is difficult, requiring changes in both thinking and behavior, but worth the reward—a lower cost structure, capability where it counts, and a resurrected role in the future of the organization.

Also contributing to this article is Mahadeva (Matt) Mani.

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