

View Point



IT Cost Reduction

“Doing More with Less”

Anita Ballaney, Vishwanath Shenoy, Michael Gavigan

Strategic IT cost reduction - “Doing More with Less”

The current economic climate will force all businesses to thoroughly examine their cost structures. While organizations in some industries are more impacted than others, all organizations are proactively seeking ways to cut costs. Further, over time as IT costs make up a higher percentage of the revenue, CIOs too will have clear mandates to do more with less within aggressive timeframes. By taking a holistic approach that is enterprise-wide, examines all IT spend and prioritizes the right IT cost reduction opportunities, CIOs will be able to successfully meet their objectives.

For more information, contact askus@infosys.com

Introduction

Historically, IT has increased profitability by reducing the cost of business operations through automation. IT has enabled organizations to handle large volumes of transactions, eliminated intermediaries, increased reach, and introduced new business channels. However, the expanding role of IT has also resulted in higher IT costs (as a percentage of revenue). It is observed that IT budgets consume anywhere from 2% to 15% of revenues and more than half of all capital spending”

Amid flat or declining revenues, organizations are striving to maintain their profitability by aggressively cutting costs. CIOs have mandates to make their IT operations even more efficient to meet cost reduction expectations from their enterprise leadership.

There is no question that the current economic climate will force IT organizations to “do more with less”. Many IT organizations will address these higher efficiency targets traditional strategies: 1) reducing headcount 2) re-negotiating with vendors (technology and service vendors), 3) shifting more to a global operations model, 4) reducing service levels, and 5) deferring discretionary spending. In short, many IT organizations will be forced to run “people-lean” operations.

For many organizations, the use of traditional cost-reduction strategies has reached a point of diminishing returns. A new, more holistic approach is required to identify incremental, sustainable IT cost reduction opportunities. This approach and its merits are discussed below.

Limitations of Traditional Cost-Reduction Strategies

The end-to-end capabilities required to meet the IT needs of the enterprise are similar to an enterprise value chain model. The demand is generated by business and serviced by core IT functions with inputs from employees, technology, and services vendors.

Traditional IT cost reduction strategies are very much like generic enterprise cost reduction strategies. They are focused primarily on the cost of supply, and somewhat on reducing discretionary demand and high service levels set by the businesses themselves.

“Supply” side limitations

Three of the most commonly used strategies to manage costs of input (“supply”) have the following limitations:

- Headcount reduction taken too deeply or frequently ends up either eliminating or impairing existing capabilities.
- Vendor renegotiations will be limited by the vendors’ profitability goals. In order to maintain margin requirements, vendors themselves will be forced to make changes to their operations, which may impact customer service levels. In extreme cases, vendors may find it unsustainable to serve at the lower rates and discontinue the partnership, in which case companies will end up incurring unforeseen switching costs.
- As organizations continue to increase the use of global operational models via captive or outsourced technology centers, they will be limited by both their enterprises’ tolerance for geographically distributed models and by the capacities of low-cost locations. Labor arbitrage gaps are diminishing due to double-digit wage rate increases in key locations. Global operational models are also facing increased risk from geopolitical instability and exchange rate fluctuations.

“Demand” side limitations

Currently, most IT organizations are meeting demand within a limited capacity by raising thresholds for approval, canceling discretionary investments, and reducing service levels. We believe this is a short-term and unsustainable solution because:

- Without effective prioritization, it simply creates a backlog that will need to be addressed at some point.
- The business will likely have their own cost savings initiatives, many of which will require corresponding IT investments.
- Changing regulations due to the recent economic crisis will create non-discretionary demand for IT resources.

In summary, while traditional strategies still can provide some marginal cost benefits, they should be used with increasing caution as their incremental returns may be short-termed or unsustainable. Both of these approaches, leveraged too much, run the risk of breaking (jeopardizing) the business.

Other limitations

In addition to the limitations of supply and demand side strategies themselves, there are other factors within the enterprise or within the IT organization that make it difficult for IT cost reduction efforts to succeed:

- Undefined objectives, goals, constraints, parameters and measures of success;
- Inadequate commitment, sign-off, ownership and/or accountability from key stakeholders to deliver the savings (e.g. take the money out of their next year's budget);
- Lack of visibility into current IT costs and cost drivers, including shadow IT spending;
- Multiple efforts addressing the same set of costs;
- No formal, integrated, enterprise-wide program across all IT cost reduction efforts with the required governance and program management infrastructure

Holistic Approach

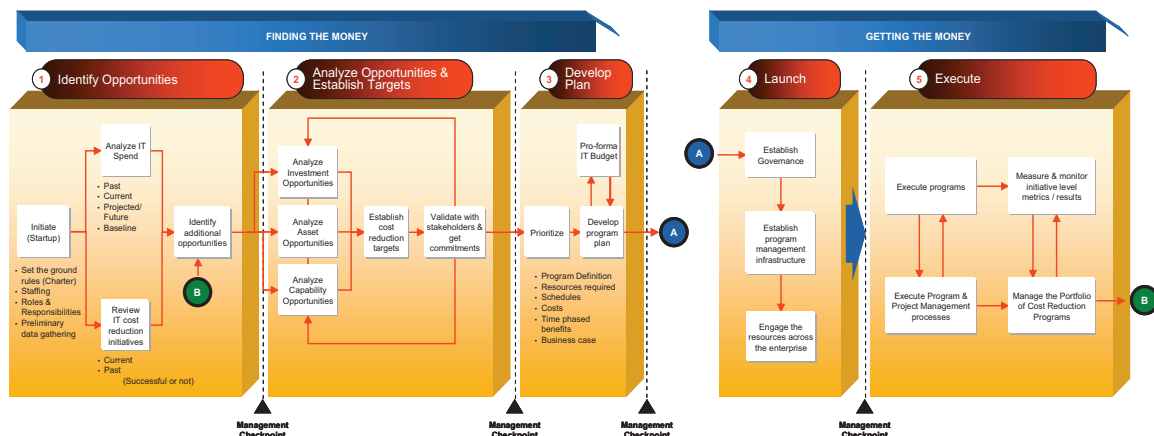
In order to achieve sustainable, long-term cost efficiencies, IT organizations must take a holistic approach.

What is a “holistic approach”?

A holistic approach is an end-to-end approach characterized by considering all sources of IT costs, fully analyzing the drivers of these costs, and executing an enterprise-wide portfolio of investments necessary to achieve measurable savings.

This end-to-end approach is implemented in five major stages, the first three of which discover the cost reduction opportunities and last two realize the opportunities. We also refer to the first three as “Finding the money” and the last two as “Getting the money”.

Figure 1: The holistic approach to IT cost reduction



In order to truly affect the enterprise-wide IT spend, the approach starts with a clearly defined charter sponsored at the highest levels of both business and IT leadership. This ensures that the scope includes all components of IT expenditure across the enterprise ecosystem, and proper engagement with the right stakeholders.

We will discuss in detail three of the key activities during these stages. These include the following:

- Leveraging multiple views to examine all sources of IT spend
- Prioritizing the right opportunities
- Executing an enterprise-wide program

Leveraging multiple views to examine all sources of IT spend

With the adoption of mature Accounts Payable and Procure-to-Pay solutions, organizations can easily track what was paid out to technology vendors. However, many IT organizations struggle to map the spend back to a business or IT capability. Consequently, they are unable to determine the true cost to serve end customers and the business value of IT. It's even more difficult to map IT "people" resources back to specific business capabilities.

When examining *all* sources of IT spend, organizations must in parallel understand all ongoing IT cost reduction efforts. This study will highlight any limitations of traditional approaches and identify successful practices across the enterprise.

We recommend examining the IT spend of an organization using the following views:

- Expenses versus Investments
- Assets versus IT Capabilities
- Lines of Business
- Fixed versus Variable
- Business Process

Expenses versus Investments

Generally many IT organizations find themselves locked each year into a cycle of spending increasing amounts of the budget on just keeping the lights on — leaving less and less to spend on new initiatives. A research has shown that the average IT organization spends 70% to 80% of its budget on maintaining the status quo versus only 20% to 30% on new initiatives. Best practices companies have taken this ratio to 60/40, and some are actually driving toward 50/50."

As businesses continue to make capital investments in IT to support business operations, the portion of the IT budget earmarked for maintenance of existing assets grows at a rate faster than that of the IT budget itself. This inherently limits an IT organization's ability to make capital investments to improve its own capabilities.

It is important for an IT organization to monitor the expenses versus investments ratio; it ensures that the IT organization is able to support the growth and innovation needs of the enterprise without significantly increasing its share of the capital budget.

Assets versus IT Capabilities

Spend on IT capabilities is spend on assets (business applications, infrastructure, and data) required to deliver business capabilities. Spend on IT capabilities is spend on people, process, technology, and assets required to deliver IT capabilities. It's critical for organizations to have visibility into investments and expense associated with assets and IT capabilities because it helps prioritize realistic IT cost reduction opportunities.

Lines of Business (LOB)

Analysis of the IT spend by LOB's provides insights into the diversity of the IT landscape. It reveals existing best practices that can be leveraged across other LOBs. In most large organizations that have grown through mergers and acquisitions, simplification and standardization across LOBs provides the most sustainable efficiencies. However, they require significant investments and strong support from the leadership.

Fixed versus Variable

IT Organizations need to maintain a healthy mix of fixed and variable costs. Outsourcing infrastructure, application development, application maintenance and IT service management are effective strategies to transform IT costs from fixed to variable. The trade-off is between maintaining capabilities in-house at fixed costs versus outsourcing them at variable costs. Frequent demand for high-skilled outsourced labor, although variable, is typically serviced at premium rates. It's important for the organization to understand the fixed and variable costs of its IT supply and invest in appropriate capabilities.

Business process

Analyses of the IT spend by business processes provide an understanding of the IT cost to serve the end customer. This view helps in identifying IT cost reduction opportunities that are driven by business process reengineering or application portfolio rationalization. Typically, organizations can reduce the IT costs of a business process by consolidating IT solutions supporting common business processes.

Prioritizing the right opportunities

Creating sustainable IT efficiencies requires investments. IT Organizations will have to prioritize opportunities as these efficiency initiatives will be competing for budgets and resources. When selecting opportunities, IT organizations should consider level of investment, benefits, the timeframe to realize the benefits, effort to implement, complexity, organization change impact, and regulatory constraints.

Other considerations for selecting the right opportunities:

- In the short-term, organizations should re-prioritize their investments based on immediate IT cost reduction goals. In the long-term, organizations should invest in enterprise-wide portfolio management capabilities to support initiatives that maximize business value.
- Savings on operating expenses from assets come from the rationalization of infrastructure, applications, and data. Infrastructure rationalization strategies are relatively more mature as hardware vendors have continued to innovate. However, these are usually capital intensive and require a high level of effort.
- Supporting capabilities such as IT Governance, Business-IT Partnership, IT Strategy and Plan and IT Financial Management have significant influence on the outcome of IT cost reduction efforts. Therefore we advocate continuous improvement of these capabilities in the IT cost reduction roadmap.
- Most IT organizations have some form of cost reduction effort already underway. These in-flight initiatives should be critically assessed in light of the newly identified opportunities. A decision to suspend, continue, or even expand/accelerate will need to be made for each one.
- Simple house-keeping activities that are not capital intensive, and controlling discretionary spend such as training, travel, office supplies, and temporary staff can provide immediate cost reduction.
- It is important to keep in mind that there is rarely a single \$100MM idea waiting out there

Executing an enterprise-wide program

Holistic IT cost reduction must be executed as an enterprise-wide program with following guiding principles:

- **Establish a clear charter and lay the ground work:** Cost reduction programs must clearly establish the objectives, expectations, measures of success, constraints, accountability, and ownership from key stakeholders, as well as obtain commitment for resources.
- **Ensure continuity between assessment and execution:** Discontinuity between assessment and execution is a key reason for cost reduction programs failing. The team involved in identifying cost reduction opportunities is ideally positioned to successfully direct the execution. This will ensure that the opportunities are realistic.
- **Align with the business early:** IT cost reduction efforts must be aligned with business priorities. Lack of commitment from business to participate in the program will result in sub-optimal outcomes.
- **Adopt rigorous program management and governance:** IT cost reduction programs must be executed using structured program management practices including communication management, stakeholder management, change management, risk/issue management, benefits management and integration management.
- **Track benefits:** Establishing measures of success and the time frames are critical to achieve the cost reduction goals.

Mitigating risks of traditional approaches

<i>Aggressive headcount reduction eliminates or impairs capabilities</i>	Typically some of the headcount reduction is replaced by vendors. We recommend assessing the right balance of fixed versus variable people capacity, retaining and developing IT capabilities, and continuously managing talent in the IT organization.
<i>Vendor renegotiation, switching costs</i>	We recommend maintaining the right balance of outsourced versus insourced operations based on the current IT spend and strategic priorities. Organizations should not waste time and resources by frequently switching vendors.
<i>Risks associated with global operational models</i>	Insulate the core business from the risks of a global operating model. Set up global operations for reasons other than pure labor arbitrage benefits.
<i>Demand for IT will continue to grow</i>	Maintain a “best practice” ratio of investment versus expense to ensure financial capacity to invest in growth. Continue to improve IT capabilities, freeing up capacity to support incremental demand.
<i>Other organization limitations</i>	Ensure that IT cost reduction is executed as an enterprise-wide initiative with the highest level of sponsorship and commitment.

Final Thoughts

IT cost reduction is now forced to the top of the CIO agenda for many organizations. CIOs must achieve substantial, measurable cost improvements in what are most likely very aggressive timeframes. While there may still be some “low-hanging fruit” left, most of these savings initiatives will need to come from areas of IT that have historically been too difficult to address. Utilizing a holistic approach is the best way to capture all the potential savings opportunities, validate them, and structure a comprehensive program plan to realize significant cost savings. The execution of this plan should be treated formally to ensure the necessary results are delivered. By doing so, and by following the analytical approach outlined above, IT will be able to successfully deliver more with less in today’s challenging environment.

About the Authors

Ballaney, Anita - Senior Principal, Information & Technology Strategies practice, New York office

Anita has over 14 years experience in helping organizations increase competitiveness and create shareholder value; she has worked with global C-level executives to develop and prioritize multi-year investments for profitable growth. Her areas of expertise include Business-IT transformation, CIO Agenda topics such as IT Transformation, IT Strategy, IT Cost reduction, Enterprise IT Financial transformation. She received her MBA from The University of Texas in Austin.

Shenoy, Vishwanath - Senior Principal, Information & Technology Strategies practice, New Jersey office

Vishwa is a Senior Principal in our Information & Technology Strategies practice. He has 10 years of experience working with clients in the areas IT strategy and Transformation, Business Process Improvement, IT Cost Improvement, IT Effectiveness, Enterprise Architecture and Strategic Sourcing. Vishwa holds an MBA in Finance and Information Systems from the Indian Institute of Management.

Gavigan, Michael - Partner, Information & Technology Strategies practice, Chicago office

Michael is a Partner in our Information & Technology Strategies practice with over 20 years of technology and consulting experience. His areas of expertise include: IT Strategy and Transformation, Cost Reduction, Business Value Realization, Enterprise Architecture, and IT Governance. He received an MBA in Finance from the University of Michigan.



For more information, contact askus@infosys.com

About Infosys

Many of the world's most successful organizations rely on Infosys to deliver measurable business value. Infosys provides business consulting, technology, engineering and outsourcing services to help clients in over 30 countries build tomorrow's enterprise.

For more information about Infosys (NASDAQ:INFY), visit www.infosys.com.