

WHITE PAPER

Reducing the Rising Costs of IT



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EXECUTIVE SUMMARY

The rules of the game have changed. Moreover, so have the expectations senior business executives have for CIOs and their departments. During the last budget-analysis cycle, tech projects underwent significant scrutiny.

The result is that short-term return on investment has become critical at many companies. Given that information technology continues to consume the lion's share of today's operating expenditures, it's no surprise that organizations of every size are paying significant attention to their budgets – with both IT and business unit managers being held accountable for the cost and performance of the technology that runs their operations.

That's why today's business agenda demands both cost cutting and revenue growth – often at the same time. For many companies, future initiatives call for holding the line on IT spending while rolling out new technologies or technology-enabled services. To achieve this goal, IT departments need to squeeze greater efficiencies from existing operations while shifting limited resources to the company's highest priorities. In many cases, cost savings are used to fund other, often mandatory, technology initiatives. The priority is to find dollars that the firm can reinvest in growth initiatives.

In "The State of the CIO 2004" survey, CIOs said that the greatest impact by far that their departments have had on the company in 2003 is reducing costs. Meanwhile, CIOs rank controlling IT costs and increasing business efficiency top priorities.

While cost-cutting is a high priority it must always be weighed against the need for innovation and IT competitive advantage. Cut too much or in the wrong places and you could be cutting your own throat. That's why all world-class IT shops produce an IT Strategy and Work Plan that is closely aligned to the business's strategy. To build your plan:

1. Meet with the business groups and **document** their business goals
2. Evaluate and **document** your IT environment from technology, operational and organizational perspectives
3. Use the reviews to determine gaps and **document** high level "functional" based requirements
4. Meet with the business groups again to confirm these requirements
5. Prepare and **document** your strategic approach

According to *CFO Magazine*, cost-cutting initiatives remain firmly at the top of most Senior Executive agendas.

In a May 2004 survey of finance executives at more than 150 large companies conducted by New York City-based consulting firm Booz Allen Hamilton, 85 percent of respondents said cost reduction is their highest priority. Nearly 60 percent reported that they are focusing on opportunities to reduce the cost of providing overhead services by trimming nonessential spending, restructuring costs and standardizing service levels. Only 3 percent said they have reduced overhead costs as much as possible.

Ongoing studies by The Hackett Group confirm that cost containment remains most companies' primary objective. "Sixty-one percent of 300 executives who responded to a recent poll said cost cutting was their number one company-wide priority," says Richard Roth, Hackett's Atlanta-based chief research officer. "There's still a strong feeling among senior executives that if their company grows, costs don't grow along with it."

While the draconian cost-cutting campaigns many organizations implemented during the downturn may already have harvested much of the low-hanging fruit, CFOs and other business executives are still looking for ways to ferret out efficiencies.

HOW IT COSTS RELATE TO OTHER COSTS OF DOING BUSINESS

An examination of how the costs of information management relate to all other costs of doing business offer valuable insights into the "information economy."

During the last ten years, U.S. companies ...

- Lowered the costs of information management required to deliver goods and to customers
- Increased per employee information management costs faster than employee compensation
- Lowered information management costs in support of revenues
- Lowered the ratio of information management costs to operating profits
- Lowered the ratio of information management costs to net assets in place
- Improved Information Productivity since 1991, but only on account of more favorable interest rates and not from measurable gains that are attributable to information technology investments

While these changes were taking place, U.S. companies also showed the following characteristics:

- Ninety-two percent of firms incurred higher expenses for information management than for the costs of ownership of their net capital assets. This makes the utility of asset-based productivity ratios (such as ROA, ROI or ROE) questionable as a measure of performance
- Forty-two percent of firms delivered negative economic value-added (EVA). This makes accounting profits questionable as a measure of operating results
- There was no relationship between the costs of information management and profitability
- There was no relationship between the costs of information technology and profitability
- The costs of information management remained concentrated in a few large corporations

Though U.S. companies have recently shown an improvement in the information management metrics, the record of actual accomplishment still falls far short of its potential. When you examine the enormous disparity between the top ranking U.S. firms (in terms of Information Productivity) and the bottom laggards, you find that a large percentage of organizations are not productive.

The bottom ranking firms spend huge sums on information management that does not deliver economic value-added. That acts as drag on further progress of the entire economy. U.S. corporations are not even close to achieving what is possible by getting information resources managed with greater effectiveness. It now becomes the task of information management to establish the further improvement in Information Productivity as one of the key goals of corporate executives.

BLOATED IT BUDGETS & EXPENDITURES STILL PLAGUE MANY COMPANIES

As Senior Executives search for ways to corral costs, they would do well to develop a consistent methodology for selecting and evaluating potential IT investments and understanding how new systems will integrate with their current IT infrastructure.

Mastering IT complexity has become a critical success factor in managing overhead, according to the Booz Allen Hamilton survey. Nearly 90 percent of respondents who described themselves as behind the competition in providing cost-efficient internal services cited "managing a patchwork of different systems" as their main IT challenge.

Research from Hackett also points to lack of standardization as a major source of IT cost overruns. "We see a lot of companies that deviate from their standard IT architecture and equipment all too often, which tends to drive up IT costs," reports Roth. "For instance, if the company's enterprise standard is Oracle, and one of its divisions decides to use SAP, those kinds of deviations complicate IT processes and waste time and money.

Roth notes that world-class IT organizations focus on standardization and simplification across the board, relying on 50 percent fewer systems than median companies and 29 percent fewer

applications. "The top companies are more likely to use data standards across all systems and are significantly more likely to have implemented a high level of standards enforcement across hardware, networking and software applications," he says.

Labor expenses historically have been the biggest cost segment of IT. World-class organizations accomplish significantly more with fewer IT workers than median companies do, according to Roth. The best companies are running their operations with 36 percent less staff than average companies. In addition, these top companies allocate their internal IT staff very differently, dedicating a significantly larger percentage of their staff to application management and less staff to addressing technology infrastructure issues.

What's more, world-class companies are more effective in their IT efforts, delivering 91 percent of all projects to specification, on time and on budget, while median companies meet these criteria only 68 percent of the time, according to Booz Allen Hamilton.

WHAT SHOULD YOU BUDGET FOR IT?

While there are no hard guidelines as to how much a company should budget for IT, industry leaders in almost every sector of the economy – from Wal-Mart to Toyota – are also companies that effectively leverage information technology. Given this reality, the IT department can no longer justify its existence simply as a cost center. Instead, CIOs are being asked to extract value from both new and existing IT investments while creating a sustainable competitive advantage for the corporation. The following chart provides benchmarks for individual industries. It's important to note, however, that now of these percentages can be taken as an indicator of what is necessary for a company to be able to leverage IT for competitive advantage.

IT Budget as a Percentage of Total Revenues:

(List of Sources: 2003)

Financial Services	4.9%
Healthcare	4.8%
Education	1.9%
Government	9.7%
Manufacturing	3.3%
Retailing	2.4%
Business Services	4.5%
Telecommunications	8.4%
Transportation	3.8%
Utilities	3.0%

HOW TO DEVELOP A STRATEGIC IT BUDGET

A key step in controlling costs is to develop a strategic IT budget for the company. The objective of this initial project is to create both a structure and process for moving forward with the company's IT needs based on key technical and business requirements. In order to do this, a company needs to complete an "as built" technical assessment, strategically prioritize gaps and areas for improvement, and then prepare the departmental budget and work plan.

The deliverables from this type of project would provide the company with the necessary facts, IT recommendations, and budgetary forecasts to prepare an executive level plan and presentation of IT goals & objectives, schedule, and costs.

BUDGETING METHODOLOGY

1.0 Review High Level Business Goals

1.1 Meet with Project Team

Meet with selected staff to confirm understanding of the project and to review all prior work to date. This meeting would cover the following items:

- Review project methodology
- Review project goals
- Establish project success criteria
- Define team roles and responsibilities
- Prepare schedule consisting of work to be accomplished, resources assigned, and beginning and ending dates for each task

1.2 Review High-level Business Goals

Meet with staff to review and further define goals and objectives, and gain a clear understanding of the present and future operation as it relates to the computer infrastructure. Review the business considerations driving this automation project to insure our direction and understanding. All analysis will be documented and reviewed with the project team for accuracy.

2.0 Perform Requirements & Environment Review

Next step is to meet with IT staff to review the current technical, operational, and organization environments to determine the existing computer system's components, procedures, and staffing. It is from this starting point that all future activities will begin. During this phase the following tasks are performed:

2.1 Review Technology Requirements / Environment

- Audit the existing Web, network, & database host(s) topology and configuration
- Audit the network and data communications infrastructure, including servers, desktop clients, gateway and third party considerations
- Identify protocols and corresponding usage, current use of security
- Review Internet considerations, including gateways, mail, web browsing, publishing, firewalls, routers, intranets
- Identify underutilized technology capacity
- Review compatibility & use of development & other supporting tools
- Review release levels of OS, database & other relevant application software
- Review the current use of system management tools

Deliverables

Technology Findings - an outline that describe the baseline technology and reflect all work completed during this task.

2.2 Review Operational Requirements / Environment

- Review requirements for performance, maintenance, administration and security
- Identify the content, size, access methods and complexity of databases as well as determining the degree of interaction across platforms
- Review interface and connectivity requirements
- Identify recurring failure situations
- Review procedures for adding, changing, and removing site/database/application users
- Identify critical information being accessed as well as the nature of information
- Identify times of peak and non-peak usage, database access patterns
- Review backup/disaster recovery procedures and fault tolerance requirements

Deliverables

Operational Findings - an outline that describes the operational aspects for the existing & future environment.

2.3 Review Organizational Requirements / Environment

- Review requirements for performance, maintenance, administration and security
- Review existing support methods & approach
- Review current approach to training
- Review the skill and responsibilities of system & help desk type support
- Identify recurring failure situations
- Identify alternative support & maintenance approaches

Deliverables

Organizational Findings - an outline (2-4 pages) that describes the how the current organization structure supports the existing technology and its deployment.

3.0 Discuss High Level Functional Requirements

At the conclusion of the above reviews, there is a review of the relevant IT needs that have surfaced. The above outlines provide the forum to discuss the appropriate automation areas. The write-up also serves as a working document and the basis for preparing the strategic approach.

4.0 Prepare Strategic Approach

The information gained in the prior steps will serve as the basis upon which to develop a strategic work plan for the company. This document includes the key technical, operational, and organizational issues facing the company, the recommendations for addressing them, a high-level implementation schedule, and for budgetary purposes, a range of costs to implement these recommendations. It's important to also note that this plan is a "skeleton" plan and requires additional design and implementation details that address implementation of each specific area of information technology.

Strategic considerations include:

- 1) "As built" environment that is working fine
- 2) "As built" environment that needs remediation
- 3) New implementations required for a stable or business impacting IT environment
- 4) New implementation that are not required but could add significant improvement to the IT environment. Tactical considerations include projected costs for the various IT projects and operations areas typically based on empirical information. Costs for process improvement will also be identified in this section.

THE IT “VALUE LADDER”

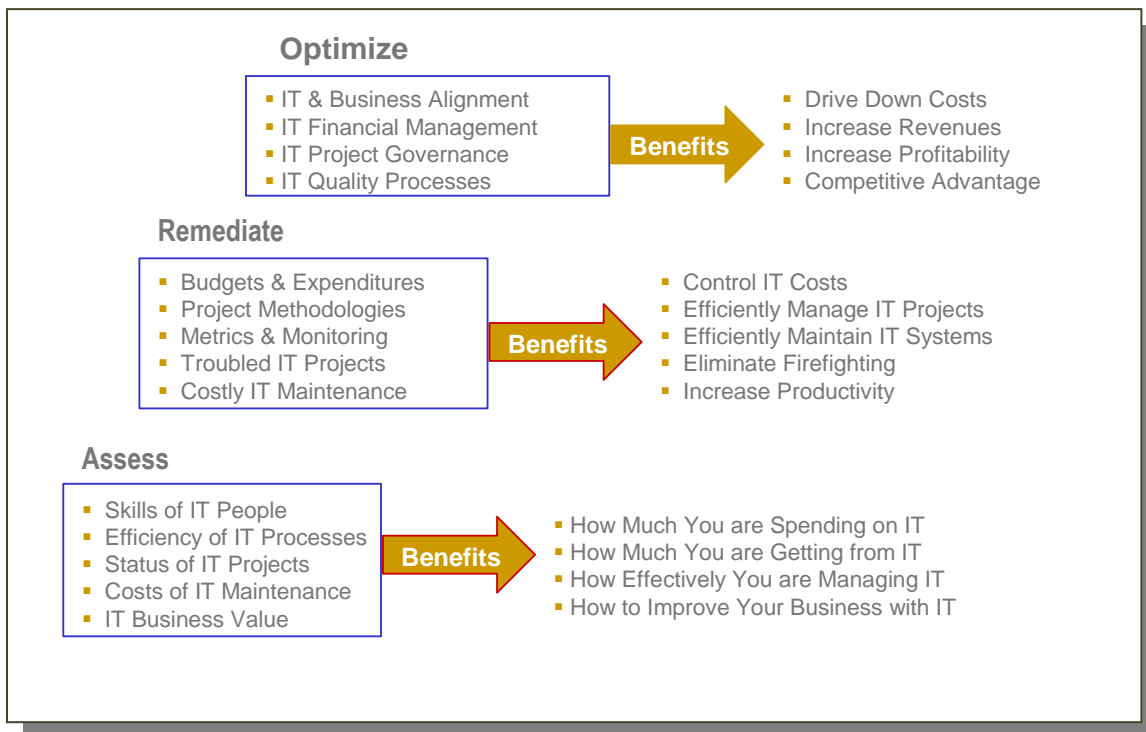
Optimizing People, Processes & Technologies

IT Evolution specializes in helping companies enhance the performance and efficiency of their IT organization. IT Evolution is able to achieve this success by bringing together an experienced team of senior professionals with technology, operations, and business expertise. By integrating this broad range of knowledge, IT Evolution has been able to help build proactive IT organizations for companies that have been unable to generate either sustained or significant business value from their IT operations

To achieve this goal, IT Evolution conducts an initial gap analysis of the client company’s IT processes, procedures, personnel and technologies. This assessment identifies the organization’s current state then maps it against desired outcomes.

These outcomes are based on the Capability Maturity Model (CMM) developed by the Software Engineering Institute. CMM is the *de facto* standard for improving both technical and business-related processes involved in the management, development, implementation and maintenance of information technology.

IT Evolution’s customized CMM approach integrates proven techniques and best practices into an ascending structure of competency that enables a company to appraise its IT organization’s maturity and process capabilities, establish priorities, and implement improvements.



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