Innovation and Transformation Through Radical Cost Cutting

Keith Bogg
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Keith has significant senior Business and CIO leadership experience in retail and other sectors. This has included:

- Retail Board Director, Direct Marketing, Homeware, Stationary & Gifts, Marks & Spencer
- CIO & Logistics Director Marks & Spencer
- EA to the Chairman, Marks & Spencer
- Global CIO ICL (Fujitsu)
- Independent Advisor, BBCT & Siemens
- Non Executive Director Roles
- ITSA (UK Government)
- Community Industry (Charity) Head of audit Committee
- Wheel Group (New Media Agency)

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Nearly a Half Century of Rising Business Productivity and Innovation Backed by Information Systems

1960 - 1988
Era of "Simple" Information System Value Creation

1988 - 2000
Era of Integrated Business System Value Creation

2000 - Present
Era of Diminishing IT Returns

Present - 2015
Era of Rising IT Productivity

New Focus for Business Innovation!
Business Investment in IT Has Lacked Real Conviction in Recent Years, Despite Strong Economic Growth

Worldwide average IT budget increases reported by CIOs (at the start of the year):

- '98: 15.0%
- '99: 15.9%
- '00: 9.7%
- '01: 10.1%
- '02: 1.3%
- '03: 0.0%
- '04: 1.4%
- '05: 2.5%
- '06: 2.7%
- '07: 3.0%
- '08: 3.3%

Number of respondents > 1,000
The Full Impact of Economic Uncertainty May Not Be Known in 2009

2009 IT Spending Change Estimates

- **Q4 2008**
  - Increase: 20%
  - Flat: 56%
  - Decrease: 24%

- **Q1 2009**
  - Increase: 24%
  - Flat: 85%
  - Decrease: 7%

When IT Organizations Will Focus on Return to Growth Strategies

- **1H 2009**
  - Increase: 1%
  - Flat: 11%
  - Decrease: 30%
  - Current Growth Strategy Continues: 58%

- **2H 2009**
  - Increase: 1%
  - Flat: 10%
  - Decrease: 2%
  - Current Growth Strategy Continues: 87%

- **Q1 2010**
  - Increase: 0%
  - Flat: 30%
  - Decrease: 70%
  - Current Growth Strategy Continues: 0%

- **After Q1 2010**
  - Increase: 0%
  - Flat: 50%
  - Decrease: 50%
  - Current Growth Strategy Continues: 0%

- **One Year May Be Over-Optimistic**
- **Few Estimates Are Trustworthy Until The Bottom is Found**

Worldwide Respondents; 2008 N=1350; 2009 N=195
IT Spending Changes in Europe & North America: Possibilities For How Far You Can Go

Europe

-12.8% 75th Percentile
-10.0% Average
-9.1% Median
-5.4% 25th Percentile

North America

-16.5% 75th Percentile
-11.0% Average
-5.4% Median
-3.9% 25th Percentile

-3.9%
-5.4%
-11.0%
-16.5%

• Most don’t know their IT budget for 2009
• Monthly changes are common – 6 months is now long term
• Initial optimism or denial is now prudent over-reaction

Source: Gartner IT Key Metrics Database; Information collected throughout 2008
Some CEOs, Hunting Harder for Profits, Are Setting Their Sights on IT Costs

18 April 2008

"It is clearly feasible for us to take 10, 15, 20 percent off our cost base, especially in information technology and operations ...."

Mr. Pandit said that one of his key priorities would be reducing Citi's information technology budget, which runs into the tens of billions of dollars. Citi's sprawling IT operation has 23,000 developers, on par with many large technology companies, and it is highly decentralized. This structure led to duplication of functions and an increase in expenses.
Citibank Is Not Alone

A Major North American Financial Services Firm

From 4% to 2%

From 13% to 6.9%

From 3% to 1.8%

Ratio of Total IT Expense to Total Corporate Revenue
CEO Demand on IT Agenda — *Radical* Option: Slash IT Costs … as a Business *Strategy Option*?

- Revenue: 100
- Cost of Goods Sold: (50)
- Cost of Sales: (20)
- General and Admin.: (8)
  - IT: (8)
  - Other: (7)
- Gross Profit: 15

If tech. performance doubles every two years, why not ...

- Cut this 50% over two years!
- Grow this 27% over two years!

Did I mention I also want 25% more service?

- Offshoring
- Consumerization
- Consolidation
- BPM
- SaaS
- VoIP
- SaaS
More for Less: Objections and Responses

- We need to spend more money on IT, not less
  - IT expense cannot grow indefinitely — true innovation benefits from *constraints*
- Business leaders won't make the difficult choices
  - New generation (Gen X) business leaders, get it
- We spend so much on operating today's IT that there is no money for upgrading
  - IT *leaders* should manage demand; have you made a case for a *one-time* capital injection?
- IT productivity is not the most important problem — helping the business is
  - Business productivity requires IT progress (but that progress is currently stifled by complexity)
M&A Slowdown Supports Radical Cost Opportunity No. 1 ...

... consolidation

World-wide M&A Deal Volumes

Source: WSJ.com, 31 March 2008
The IT Industry Is Busy Constructing Radical Cost Opportunity No. 2 …

"A style of computing where massively scalable IT-enabled capabilities are provided 'as a service' to multiple customers, using Internet technologies."

"Cheap, utility-supplied computing will ultimately change society as profoundly as cheap electricity did." Nicholas Carr
Consumerization and Semiconductor Progress Lead to Radical Cost Opportunity No. 3 …

... "disposable"

<table>
<thead>
<tr>
<th></th>
<th>CAGR 2007-2012</th>
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<tbody>
<tr>
<td>DRAM</td>
<td>-32.79%</td>
</tr>
<tr>
<td>SRAM</td>
<td>-10.76%</td>
</tr>
<tr>
<td>PSRAM</td>
<td>-23.83%</td>
</tr>
<tr>
<td>NAND Flash</td>
<td>-48.09%</td>
</tr>
<tr>
<td>NOR Flash</td>
<td>-22.97%</td>
</tr>
</tbody>
</table>
Enterprise IT Modernization Offers Radical Cost Opportunity No. 4 …

- Don’t modernize this …
- Until you know how much of this you need
Internet Penetration and Maturity Lead to Radical Cost Opportunity No. 5 …

Globalization

- Niche needs of dispersed IT customers = addressable markets
  - Economies of scale reduce unit costs
  - Follow-the-sun progress rates enabled
  - And, yes, labor arbitrage still has an impact
A Framework for Cost Optimization

Enable Innovation & Business Restructuring
*Implement process improvement, business restructuring and innovation*

Joint Business and IT Cost Savings
*Implement cost-saving technologies in conjunction with the business*

Cost Savings within IT
*Identify opportunities to reduce IT costs*

IT Procurement
*Get the best pricing and terms for your IT purchases*

Execution of various types of cost optimization will involve different parts of the organization and varying levels of control by IT alone.
A Maturity Model for Cost Optimization – It’s Not as Linear as One Would Think

- Enhanced cash flow is the ultimate goal for many
- Cutting spending may increase costs
- Estimates of recession depth will dictate optimization actions

<table>
<thead>
<tr>
<th>Level 0</th>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
<th>Level 4</th>
<th>Level 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT Budget Management</td>
<td>IT Procurement Actions</td>
<td>Cost Savings Within IT</td>
<td>Joint Business and IT Cost Savings</td>
<td>IT Restructuring &amp; Process Improvement</td>
<td>Investment or Restructuring Required to Cut Long Term IT Costs</td>
</tr>
</tbody>
</table>

Emergency Cost Optimization

Cut IT Spending

Short Term

Cut IT Costs

Long Term
Where the Most Attention is Focused For IT Cost Optimization: Areas of Biggest Impact

Question: Please select the category from where IT has made the biggest impact in reducing business costs during the past year.

1. IT Procurement--best pricing and terms for IT purchases
   - 26%

2. Cost savings within IT--reducing costs within IT
   - 45%

3. Joint business and IT cost savings
   - 19%

4. Enabling innovation and business restructuring using IT
   - 10%

N=310, 2009 Survey Data
<table>
<thead>
<tr>
<th>IT Procurement</th>
<th>Cost Savings within IT</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Open Source Software: 75% Savings in Maint./License</td>
<td>• Virtualization &amp; Consolidation: 20% Less Workload</td>
</tr>
<tr>
<td>• Software as a Service (SaaS): 80%</td>
<td>• IT Asset Mgt.: 8-10% Per Managed Asset Per Year</td>
</tr>
<tr>
<td>• Enterprise SW Agreement: 20-50% Dropping Maint.</td>
<td>• PC Power Mgt: 43% Per Year vs. Non-Best Practice</td>
</tr>
<tr>
<td>• IT Outsourcing Offshore: 10-40%</td>
<td>• Apps Power Mgt: 18% Over Five Years</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Joint Business &amp; IT Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Apps Portfolio Reduction: 50% for 20% Savings</td>
</tr>
<tr>
<td>• Cancel Projects: Reduce Discretionary Spend by 75%</td>
</tr>
<tr>
<td>• Teleworking: 20% Reduction In Net Occupancy Costs</td>
</tr>
<tr>
<td>• PMO: 5-20% Productivity Improvement</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Process Improvement, Business Restructuring &amp; Innovation</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Business Process Mgt. Technology: 18% Avoidance</td>
</tr>
<tr>
<td>• Shared IT Services: 15-20% is Typical, 40% Maximum</td>
</tr>
<tr>
<td>• Territory Mgt. Software: Increase Sales 1-3%</td>
</tr>
<tr>
<td>• Online Marketing &amp; Lead Mgt: Increasing Revenue 20%</td>
</tr>
</tbody>
</table>
### Efficient IT Cost Optimization Challenges IT Financial Management Capabilities

<table>
<thead>
<tr>
<th>Efficiency Targets</th>
<th>Actions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Centralization &amp; Consolidation</td>
<td>• Data Centers, Servers, Network Providers</td>
</tr>
<tr>
<td></td>
<td>• Help Desks, Storage, Data, Provisioning</td>
</tr>
<tr>
<td>Legacy Systems</td>
<td>• Modernization &amp; Migration</td>
</tr>
<tr>
<td></td>
<td>• SaaS Alternatives</td>
</tr>
<tr>
<td></td>
<td>• Business Process Outsourcing</td>
</tr>
<tr>
<td>Evaluate Procurement Activity</td>
<td>• Lease vs. Buy vs. Outsourcing</td>
</tr>
<tr>
<td></td>
<td>• Deferral &amp; Renegotiation – All IT Vendor Categories</td>
</tr>
<tr>
<td></td>
<td>• Install Additional Approval Gates to Delay Action</td>
</tr>
<tr>
<td>IT Asset Management</td>
<td>• Extend Useful Life of Assets – From 3 to 4 Years</td>
</tr>
<tr>
<td></td>
<td>• Cancel Licenses – Rationalize Multiple Tool Sets</td>
</tr>
<tr>
<td></td>
<td>• Focus on End User and Mobile Device Optimization</td>
</tr>
<tr>
<td>Lower Service Levels</td>
<td>• Help Desk Change from 7X24 to 5X8</td>
</tr>
<tr>
<td></td>
<td>• Availability: 99.100 to 97.500</td>
</tr>
<tr>
<td></td>
<td>• Desktop Provisioning: 2 Days to 14 Days</td>
</tr>
<tr>
<td>Internal &amp; External Benchmarking</td>
<td>• Define Quantitative Goals for Effective Cost Savings</td>
</tr>
<tr>
<td></td>
<td>• A Unifying Principle for Fact-Based Action</td>
</tr>
<tr>
<td></td>
<td>• “What If” Analysis for IT Legitimacy</td>
</tr>
</tbody>
</table>

Many IT Organizations Are Now In the Middle of Significant Efficiency Programs
Effective IT Cost Optimization May Require New or Continued Investments

<table>
<thead>
<tr>
<th>Effective Action</th>
<th>Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT Vendor or Sourcing Management: Refresh</td>
<td>• Enterprise Agreements Limit Vendor Excesses</td>
</tr>
<tr>
<td></td>
<td>• Creates Leverage to Encourage Partnership Behavior</td>
</tr>
<tr>
<td></td>
<td>• Prepare for Cloud Computing, ADAM, Industrialization</td>
</tr>
<tr>
<td>IT Industrialization</td>
<td>• Process Evolution Negates Customization Benefits</td>
</tr>
<tr>
<td></td>
<td>• Standards Adoption Drives Commoditization Benefits</td>
</tr>
<tr>
<td></td>
<td>• Move From Fixed to Variable or Semi-Variable Costs</td>
</tr>
<tr>
<td>IT Performance Management</td>
<td>• Connect IT Value to Business Value</td>
</tr>
<tr>
<td></td>
<td>• Portfolio Approach to IT Investment Decisions</td>
</tr>
<tr>
<td></td>
<td>• Chargeback: Continuous Discussion About Costs</td>
</tr>
<tr>
<td>IT Value Management</td>
<td>• Forced Harvesting of Value &amp; Optimization Promises</td>
</tr>
<tr>
<td></td>
<td>• Instills Discipline &amp; Rigor to Previous Decisions</td>
</tr>
<tr>
<td></td>
<td>• Better IT Value Communication</td>
</tr>
<tr>
<td>Applications Portfolio Management</td>
<td>• Focus on the Root Cause of IT Expenses</td>
</tr>
<tr>
<td></td>
<td>• Cosmetic Differences in Apps Ripe for Rationalization</td>
</tr>
<tr>
<td></td>
<td>• IT Alignment from Business Discussions</td>
</tr>
<tr>
<td>Green IT</td>
<td>• Significant Overlap w/Traditional Optimization Goals</td>
</tr>
<tr>
<td></td>
<td>• Focus on Electricity Costs and General Frugality</td>
</tr>
<tr>
<td></td>
<td>• Improves Business Case for Optimization</td>
</tr>
</tbody>
</table>

Long Term IT Planning to Deliver Business Value & Make Better Decisions
Shared IT Services Will Challenge The Best Run IT Organizations

**Benefits & Requirements**
- Increases Cost Transparency
- Requires Sophisticated Vendor Management
- Drives Industrialization and Lower Costs
- Requires Sophisticated Chargeback
- Run IT Like a Business

**Cost Optimization Benefits**
- 40% Maximum Due to Redundancy Elimination
- 15-20% is Typical
- 20-30% for Share IT Infrastructure
- 25% for Applications Development, Support, Maintenance
- Risks & Drawbacks
  - Highly Customized or Legacy Applications
  - Requires Investment in Service Mgt. and Project/Portfolio Mgt. Tools
  - Existing Strong Architecture Will Reduce New Savings – Already Well Optimized

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*Gartner*
Methodologies, Frameworks & Standards: Significant Savings for a New Paradigm

- **ITIL Overall:** 20-30% IT Operating Cost Savings in 3 Years
- **Capacity Mgt:** 5-10% savings due to server consolidation & contract renegotiation
- **Configuration Mgt:** 10-25% savings in ongoing hardware maintenance & support costs
- **Other Benefits**
  - Easier & faster sourcing due to a common vocabulary
  - More agile in the future
  - More predictable costs
Inspiration: Where Can We Find the Best Examples of Radical IT Cost Thinking Today?

Tesco knows where IT could add new value

Kingfisher almost halved its IT cost as percentage of revenues

Ikea's CIO carries an old and battered phone

But it won't implement until the price is right

By creating shared services across its DIY chains

It spends only 60% of IT budget "keeping the lights on"
### Case Example: HP

#### Top five IT initiatives

<table>
<thead>
<tr>
<th>Initiative</th>
<th>Description</th>
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</table>
| **Portfolio management**                        | • 1,200+ → ~500 active projects  
• Global standards & metrics  
• IT ROI (our revenue)  
• 3,500 → 5,000+ → ~1,500 applications |
| **IT workforce effectiveness**                  | • 100+ → ~29 core sites  
• <50% development → 80% development, 20% support  
• Optimize headcount  
• ~50% HP employees → >90% HP employees |
| **World-class IT**                              | • Best-in-class operational efficiency  
• Benchmark cost structure  
• Showcase for the enterprise customer |
| **Enterprise data warehouse (EDW)**             | • 762+ datamarts → 1 enterprise data warehouse |
| **Global data centers (DCs)**                   | • 85+ → 6 DCs, ~400,000 sq. ft.  
• Next generation data center model  
• 1 global network |

Source: [www.hp.com](http://www.hp.com)
Case Example: HP

Data center consolidation
Global data centers – next generation data centers (NGDC)

<table>
<thead>
<tr>
<th>Less</th>
<th>More</th>
</tr>
</thead>
<tbody>
<tr>
<td>60% retirement of legacy applications</td>
<td>Global applications</td>
</tr>
<tr>
<td>30% fewer servers</td>
<td>80% more processing power</td>
</tr>
<tr>
<td>Decrease in cost of storage</td>
<td>Double the storage (all data replicated)</td>
</tr>
<tr>
<td>Half the cost of networking</td>
<td>30% more bandwidth</td>
</tr>
<tr>
<td>Less HP IT cost</td>
<td>More capability</td>
</tr>
</tbody>
</table>

Source: www.hp.com
The New Era of Low-Cost, Highly Effective IT Will Require a New Way of Thinking

<table>
<thead>
<tr>
<th>Structure</th>
<th>From</th>
<th>Change</th>
<th>To</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Vertical silos independently exploring IT</td>
<td>Tighter integration of strategy</td>
<td>Horizontal structures optimizing business outcomes through shared IT</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>Focus on the advances in data-processing volume from Moore's Law</td>
<td>Target earnings per IT employee</td>
<td>Focus on the cost and flexibility advances from the Internet and metadata</td>
</tr>
<tr>
<td>Process</td>
<td>Supporting the processes of business operations</td>
<td>Data-supported decisions and systematized execution</td>
<td>Enabling the management processes of change and improvement</td>
</tr>
<tr>
<td>Mind-Set</td>
<td>Belief that IT is a growing cost best capped by percentage of revenue</td>
<td>Belief that IT can radically improve its internal productivity</td>
<td>Belief in IT as investment best measured by its productivity contribution</td>
</tr>
</tbody>
</table>
The Emerging Trends in Radical Cost Cutting

The Trends:

- CEOs are looking for cost savings as economic conditions worsen
- Technology progress is making possible far-lower-cost, high-flexibility models of delivery

The Implications:

- During the next three years, we could see radical changes to the way business leaders view IT strategy
- IT could be "decapitalized" — turned almost entirely into an operating expense, but this might make it harder to control
Recommendations for CFOs and CIOs

- The world has changed: Challenge underlying assumptions
- Develop an understanding of “good enough”: commodity IT or differentiation using IT
- Determine leverage benefits of IT: Focus more on fixed or variable IT cost structure?
- Use current cost optimization prioritization schemes for new investment business cases

- Set expectations for lower IT service levels
  - When you have less funding, there isn’t much left to do and strategic decision will be made
  - Ask for help from internal and external clients: Ask everyone to pitch in

- Determine what IT management capabilities and disciplines are missing now that are needed for cost optimization
- Determine how much you can cut: Better benchmarking to make more informed decisions
Innovation and Transformation Through Radical Cost Cutting