The Cost Equation

"For technology executives to become business executives, they have to be skilled at cost control"

Sue Bushell 03 July, 2008 12:13:30

Part 4 of CXO Priorities | COST CONTROL

Australian mining companies may still be enjoying a boom, but just about anybody else who sells anything into a world that is denominated in US dollars is struggling enormously with cost pressures, says Gartner EXP research director Andy Rowsell-Jones.

"Among our members, we're hearing from the manufacturers particularly and they are complaining about the need to stop projects and cut costs," he says. "Now I haven't heard it from our financial services members. They may be playing a different game or maybe they have more of a domestic audience, which is relatively different because the Australian levels of wealth are up and people are feeling quite bullish. Certainly the exporters whose products are denominated in US dollars are struggling a bit with price as a big issue."

CIOs have little "best practice" to draw on in the way IT budgets/costing support the IT governance process

That means the CIO's priority remains finding ways to cut costs. The balance sheet of the typical organization is divided between people, technology leases and licences and applications, Rowsell-Jones says. Finding cost savings means first having a hard look at your application base: Are you using all of the applications you're paying for? Are all of the development projects under way necessary, or can some be put on hold?

You should also closely examine your resource base, he says. Do you need all those people, or are there alternative sourcing models that would better take into account your workload? "Often in an internal IS organization, we build the capabilities and the volume or the scale of that organization to fit peaks. It may be that actually the workload is more variable and therefore we need to move to a different resource supply model, and that might require us to change to an outsourcing arrangement to give us stability," Rowsell-Jones says.

In the hardware space, he says, the organization should consider whether it should own and operate its own technology. Would it be better to get somebody else to own and operate it? Would it be appropriate to make a hardware change? For example, the argument for virtualization is becoming stronger and stronger as the need to squeeze costs comes through, Rowsell-Jones says.

The sleeper issue in all this is green IT, which is starting to gain an enormous amount of momentum. Many Australian CIOs currently seem to be conflating "green" - reducing energy consumption - with "lean", but Rowsell-Jones says some steps the organization will end up having to take in the interest of running a greener operation may increase costs in the short term. And he says organizations finding they have to start spending money to reduce energy consumption and cut e-waste will face some painful trade-offs.

"It's the classic management problem: Is the more pressing issue to be able to deliver those value-adding projects, or to virtualize my server farm to reduce cost and maybe save energy, or to move away from personal printers and to remote management which turns PCs off at night? All these questions will have to be resolved," he says.

The Budgeting Mess

In September last year Cutter Consortium completed a survey on IT budget and costing practices (the second year of the study) that showed in most organizations, IT budgeting and costing practices are "a mess". Worse, it revealed CIOs have little "best practice" to draw on in the way IT budgets/costing support the IT governance process. "Indeed, there's little to suggest in practices followed that CIOs understand how important the budget/costing process is to successful IT governance," Cutter Senior consultants Bob Benson and Tom Bugnitz declared.

The consultants found there were no common practices in the way IT budgets are structured; in establishing what is included in "IT costs" and therefore IT budgets; in how business units pay for (and therefore govern their use of) IT; in managing the IT budget and the approval of IT budgets or in identifying the "value" of IT spending. And they said it was striking that none of the general characteristics of the company and how it manages IT - factors such as IT budget size, company size, industry, geography, and company complexity (for example, multiple business units) - have any correlation to their budget/costing practices.

"We believe in two foundational principles about IT governance," the analysts said. "First, 'If you don't know cost, you don't know anything' . . . This is critical because of the second foundational principle: 'Managing money (costs) is the foundation for IT governance'. Everything IT governance stands for - investment prioritization, strategic effectiveness and impact of IT, IT's performance, IT's value - is about managing the costs/investments in IT. Some of the crucial governance questions are: What are we spending on? What are we getting for what we're spending? Where should we be spending? Cost is central to understanding and deciding these questions. Managing cost is IT governance.

"Yet, CIOs apparently don't understand how to identify, manage, and communicate IT costs. It's amazing: many CIOs don't even know what the costs are (except in total) inside the 'IT black box' of continuing lights on costs. In addition, most business-unit executives don't see the full cost of the IT their business unit consumes."

Cutter says there's no doubt every IT organization keeps track of costs, stays reasonably within budget and tracks its vendor, contractor, and internal direct costs. It's just that few IT organizations know their total costs (including things like space, energy and benefits) or their application costs (including support, infrastructure and operational costs), and few IT organizations provide specific transparency into these costs for each of their company's business units.

The CIO is responsible for setting corporate governance for the company. Together with the CFO he or she needs to work out expenditure levels and financial tracking mechanisms, says Rob de Vries, CIO at Dutch company Intrum Justitia.

It is the job of the CIO (among many other things) to make IT spending and project spending easy to track, insightful and above all honest. By making IT cost totally transparent he or she really helps the entire company and promotes actions that will improve the overall performance.

"As the amount of data is probably vast - I had 22 countries with IT departments - I suggest you use the following four buckets of spending: Strategic = Grow the business, Tactical = Position the business, Necessary = Maintain the business, Other = everything which does not fit first three categories. You know your business is on the right track - or at least IT-wise - if the amounts resemble roughly 40 per cent, 30 per cent, 20 per cent, 10 per cent. That is, most IT money is spent on growing the business and positioning the company for future growth. If the 'Other' bucket is above 10 per cent an alarm bell should ring, unless it just means funds are being wrongly labelled. CIOs like me know this and always try to act accordingly, I hope," de Vries says.

Keeping a Lid on Project Costs

When it comes to projects, the best way to control costs is to establish a clear business case with well defined success factors and ROI projections right from the start, before a project gets past its initiation phase, says Grant Cause, a senior consultant technology services with SMS Management and Technology.

Once the project is under way you should deploy a proven project management methodology like PRINCE2, with built-in management structures, controls and processes to ensure critical items such as timelines, costs, risks, issues, and so on are taken care of and where required escalated to the project board to deal with. On project completion, Cause says, you can enforce the post project review to learn from the experience and bring those learnings into the next project.

And Cause says savings can also be achieved if the organizational culture supports best practice like establishing a PMO to oversee project governance, adopting the MSP (managing successful programs) methodology, and by rewarding innovation within the organization that contributes to the bottom line.

Many IT organizations manage their costs from a technology standpoint. These costs continue to grow as more technology is implemented, notes Marc Lachance, a specialist in eliminating barriers to effective ROI and IT president at M E Lachance & Associates, who likes to call himself "the IT Process Doctor". The CIO needs to examine the value he or she is providing to the business as a result of the IT systems available. "A particular service grows by volume," Lachance says. "The price of technology is coming down. You should be driving down the cost of that service, especially from a transaction cost perspective.

"Of course CIOs will be most effective when they come at their jobs from the position of the CIO providing the information on which the business can run; it's not about the technology any more," he says.

Another way to control costs is to initiate controls that ensure spending above certain levels must be approved at a higher level. This puts more scrutiny on spending, says Henry Will, an IT innovator and strategist from New York City.

"As for CIOs, my experience as a certified PMP (project management professional) has shown that all IT projects should be charged back to the business unit or units sponsoring the work being done. This automatically controls cost by ensuring that each IT initiative is supported by a unit within the business. Where I've seen this implemented in organizations, I see that only projects that have a valid ROI are undertaken. My experience has also been that these projects are higher value and have a higher level of buy-in from the business," Will says.

Of course cost control often implies cost minimization, but minimizing costs is only a part of controlling costs - it also includes planning for costs: It is important to understand that cost control is about providing value, and that sometimes you need to spend money in order to make money, says Alan Perkins, head of an IT consultancy called Profound Information.

CIOs as business leaders need to ensure they are familiar with the overriding business objectives and know what the company's unique value proposition is and how to ensure that the company's ICT infrastructure - both soft and hard - is aligned with that. Sometimes this requires money and training, but other times it just takes clear thinking.

"In the current world, CIOs are best advised, in my opinion, to assist the business to focus on its unique selling proposition and leave others to focus on theirs. This means making use of technologies like software as a service, platform as a service as well as outsourced hardware."

Perkins urges CIOs to look at the Elastic Compute Cloud, Salesforce.com's new force.com Platform and the tools to access it. For hooking core applications into the "matrix", he suggests they take advantage of all the burgeoning APIs provided by service-oriented architecture, where companies leverage information delivered, and business intelligence is served by publicly available content as much as it is served by proprietarily generated information.

"And finally, CIOs brought up in the technology backroom must invest in learning to become proficient at what makes a business run.

"After all, they are the custodians of much of the central nervous system and if they don't understand the potential value in the input available and the potential output possible, they may well be holding their company back, with no one the wiser," he says.

Click here for Part 5 of CXO Priorities | AGILITY

More about Black Box, Salesforce.com, ACT, Cutter Consortium, Gartner

IDG Sites: PC World | GoodGearGuide | Australian GamePro | Computerworld Australia | CSO Online | LinuxWorld.com.au | Techworld | ARN | CIO Executive Council