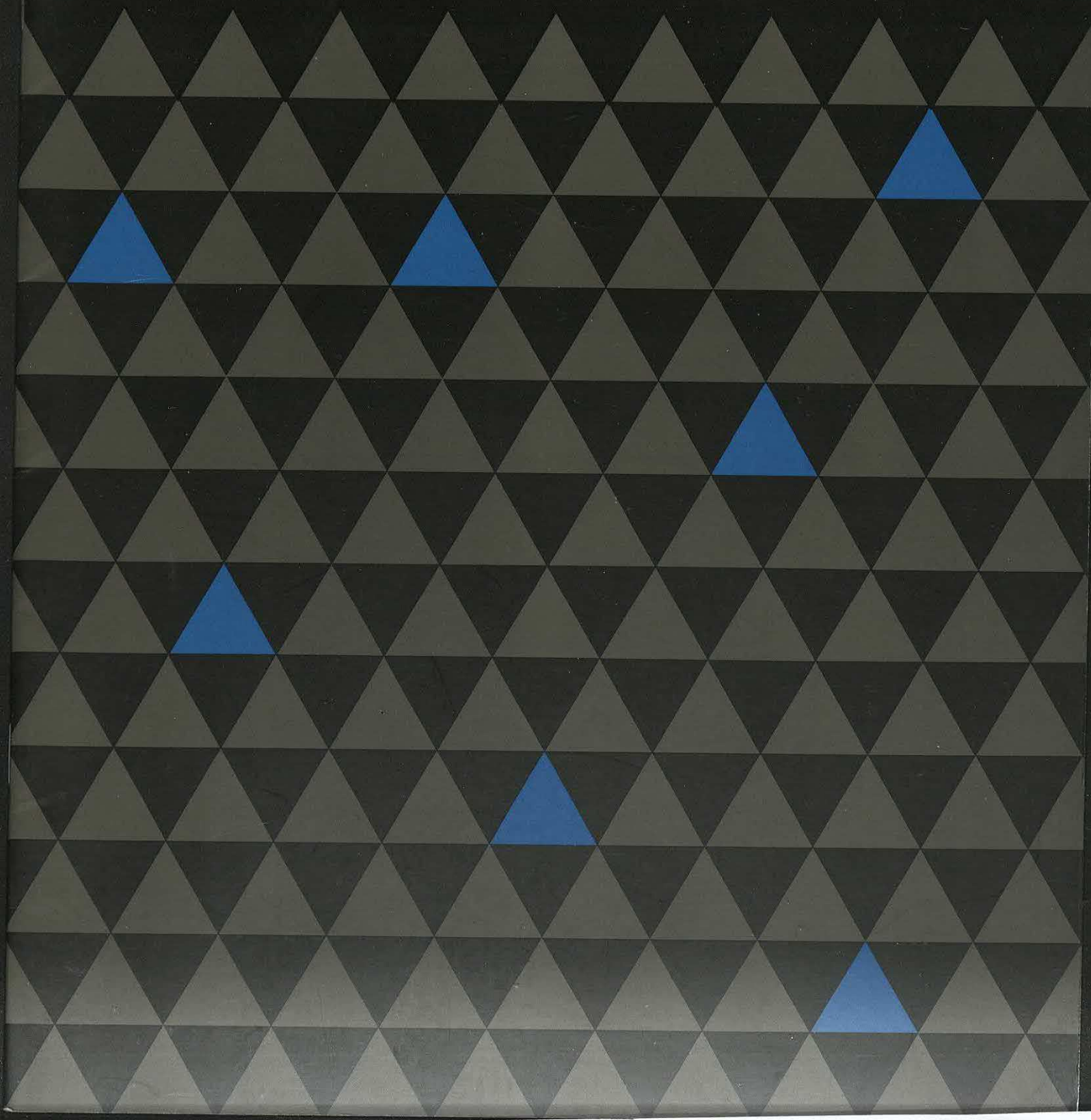
IT in a Cold Climate

BUTLER COX FOUNDATION

A Directors' Briefing
June 1991



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A Directors' Briefing
by John Kinnear

By its very nature, the IT function has to take a long-term view. It operates systems that were designed yesterday, but it plans systems that will run tomorrow. Recessions, on the other hand, are short-term, or at least, one hopes they are. This Directors' Briefing provides guidance on how the systems department should respond when the business it serves hits a downturn.

Directors' Briefings are published by the Butler Cox Foundation and provide directors and senior general managers with practical guidance on the effective exploitation of information technology within their enterprises.

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A Directors' Briefing

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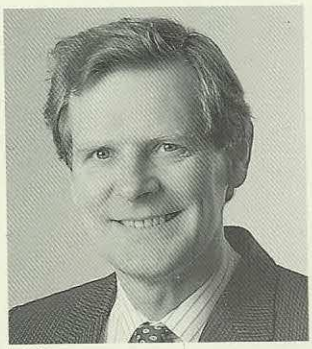

John Kinnear is a founder and a director of Butler Cox and is currently responsible for the Group's research activities. He has over 25 years of experience in IT, both as a systems manager and as a consultant.

Continuous economic growth has so far eluded every industrialised nation. Nevertheless, few organisations are well prepared for recession – most plan on the assumption of uninterrupted growth in demand for their products or services. Corporate engines do not have a very effective reverse gear.

It is not, of course, only general economic recessions that cause a business downturn in particular market sectors or even in individual companies. The global travel industry has been hit on several occasions by events such as terrorism and international conflict. Overcapacity in industries such as banking or airlines puts mounting pressure on the weaker players. Changes in technology can render whole product ranges obsolete. In all these cases, however, a harsh general economic climate tends to expose and magnify the problems.

According to the severity of the downturn – and the adroitness of the management – companies take a variety of measures to respond to such a situation. What is at stake might be the preservation of a company's position in the market, or the maintenance of its independence or even its very existence. It may be concerned about retaining its capability to respond when the market recovers, or it may simply be obsessed with survival. Possible actions range from cost-cutting to closing or selling off parts of the business.

While the business deals with short-term market pressures and the cost of finance, the systems department endeavours to retain a long-term view. Some would say that it has to. The systems in place today have taken years – in some cases, decades – to build. They represent massive investment. They cannot be changed instantly. Moreover, the systems that are being built for tomorrow will pave the way for the success of the business over the next 10 years. Surely (it is argued), they should not be jeopardised by shorter-term considerations?

Should the systems department continue with its plans regardless of the fluctuations in the short-term position of the business? Such a line has two obvious drawbacks. First, it hardly squares with the frequent claim that IT should be viewed as a strategic business weapon. What use is a weapon if it cannot be used when you are under attack? Second, any systems department operating in such a way soon finds itself out of step with the rest of the business. The most important thing about the long term is to ensure that you are part of it. So, how should the systems department respond? The actions taken by some systems directors in response to the current economic climate suggest some useful guidelines.

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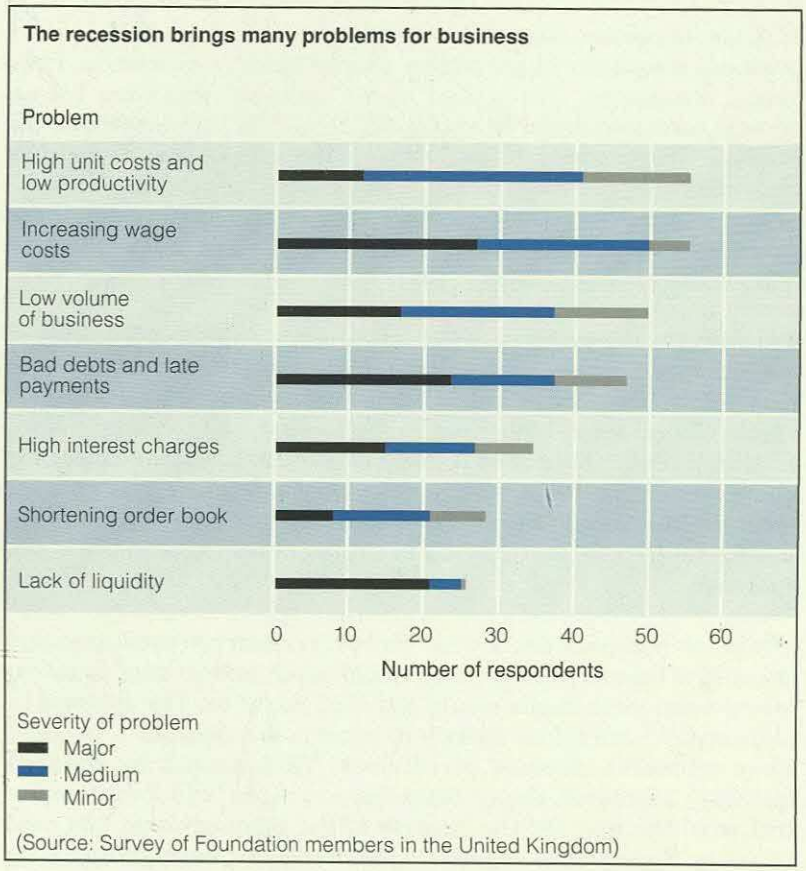
Keeping IT in tune with the business

The main problems affecting businesses in the current economic climate are high costs, low productivity and low sales volume, as the diagram below shows. The main response takes two forms: new initiatives in sales and marketing, and cost-cutting, as the diagram opposite illustrates. A brief survey by the Foundation of large companies in Britain (one of the first countries in Europe to have been affected by the recession) revealed that over 80 per cent had taken action in one or both of these areas. They reported overwhelmingly that a similar response was required from the systems department. Overall, some 40 per cent of systems departments were directed to cut their costs, and a further 35 per cent were told to freeze them. Particular emphasis was placed on staff cuts – 85 per cent of systems departments were instructed to freeze or reduce staff levels.



Faced with a demand to cut costs quickly, the instinctive reaction of many systems managers is, "It can't be done". They point out that as systems are a long-term investment, most of the costs are of a long-term nature, committed contractually in advance. They cannot be changed quickly. An example of a typical systems budget is shown opposite. The discretionary portion is only 13.7 per cent. Typically, systems managers will use figures like this to explain how it is virtually impossible to cut their budgets by more than 2 or 3 per cent. This attitude can alienate business managers for whom there is no alternative to substantial cost-cutting.

Systems managers often claim they have little scope to reduce costs

An extreme example is provided by a major insurance group. Like many others in its field, it was coming under intense competitive

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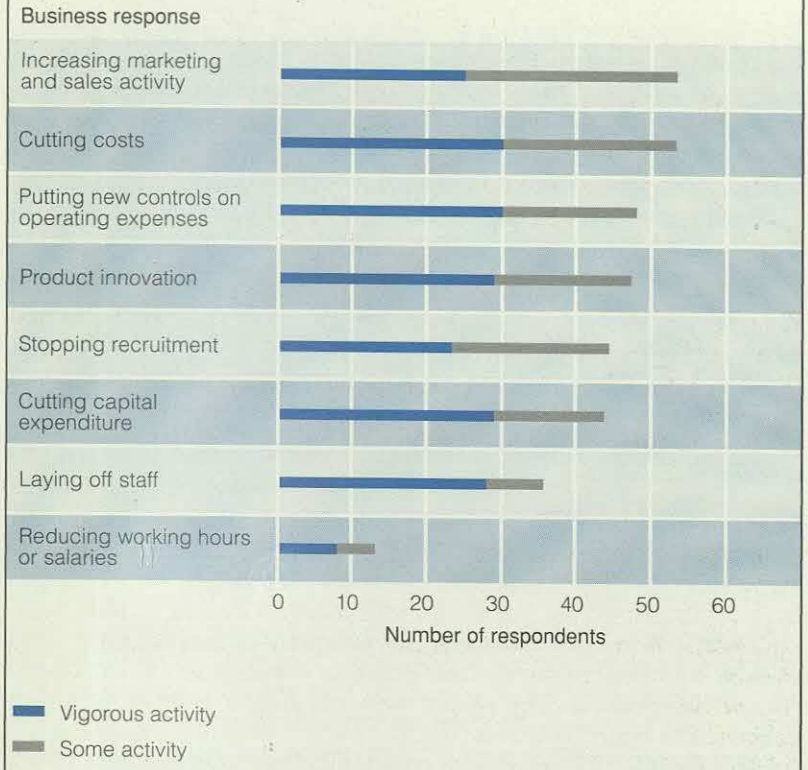
Business is responding by increasing marketing and cutting costs



(Source: Survey of Foundation members in the United Kingdom)

Only a small part of the systems budget is discretionary

	Total (%)	Discretionary (%)
Hardware		
Lease	35.0	—
Maintenance	4.5	—
Purchase	4.5	4.5
	44.0	
Software		
Lease	8.0	—
Maintenance	0.8	—
Purchase	5.2	5.2
	14.0	
Staff		
Salaries	29.0	—
Overheads	9.0	—
Contractors	4.0	4.0
	42.0	
Total	**100.0**	**13.7**

pressure, which affected premium levels, sales costs, and hence, margins. The group's recovery strategy was clear. It involved resetting premium levels, focusing on the more profitable areas of activity at the expense of volume, and cutting operating costs. Its market strengths made this a perfectly feasible strategy to pursue.

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such a specialised solution. Instead, a standard back-up agreement was concluded with a systems house, for a small proportion of the originally proposed cost.

The main hardware vendor proved remarkably supportive in these moves, recognising that a continuing good relationship was more important than fighting for short-term income, to the customer's detriment. Indeed, few customers recognise their powers of renegotiation in the current climate in many fields of IT supply.

In a cold climate, IT suppliers may be prepared to negotiate special deals

In general, major savings can be made by questioning assumptions that may well have been correct at the time of the original decision. It is not that they were wrong; it is that they are no longer valid under the changed business circumstances.

Cutting costs without cutting capability

A 20 per cent reduction in costs need not result in a 20 per cent reduction in IT capability. In most systems departments, there is scope to reduce costs by making changes in the organisation, in staffing and in other internal functions.

At the International Stock Exchange London, a new IT director was appointed in January 1990. One of his early actions was to change the organisation of the systems department fundamentally, from one focused on technological functions to one based on projects. This had an enormous impact on the ability of the department to meet business objectives while, at the same time, achieving substantial staff reductions.

Staff cuts were also made – and continue to be made – in the systems development area and in business administration at Midland Bank. The cuts did not, however, adversely affect morale. The systems director said, "No-one likes to see cuts, but the overall effect is positive. People can see that we are tackling the problem. We are not simply lying back and letting the business drift along in this climate. We are actually proud of the fact that in some areas, such as the IT planning and architecture groups, we have been able to cut numbers and costs by 40 per cent. Most IT directors would boast of the numbers that they employ."

Staff cuts need not affect morale

An early action of one newly appointed systems director was to reduce the number of management layers in the systems department. This involved some redundancies. It also involved breaking through the old culture, where an individual's importance in the organisation was directly related to the number of staff reporting to him. In addition, most internal meetings were cut. There were far too many of them and they lasted far too long. The department also tended to write long papers about everything, and to write papers about those papers. This was stopped. "Don't write less code, write fewer reports", was the instruction. It is surprising how organisations fail to recognise the amount of resources that such activities consume. The maxim has to be to prune activities before shedding skilled staff.

Accommodation is another area to be tackled. The standard of accommodation that might be justified in good times is not the same as that which can be afforded in a different climate. It is

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Systems directors should lead by example

better, where possible, to cut floor space than to cut skilled resources. Again, cuts have to be led by example. The same systems director felt that he could hardly sit in the spacious office he inherited while lecturing on the need for frugality. He moved out. This was not only important in setting an example to his own department. He was seen by the business to be taking the lead.

His next move was to close a data centre and transfer work to other centres in the group. The users did not even notice.

He then tackled salaries. A salary increase of 10 per cent had been budgeted for the whole department. This was cut to an average of 7 per cent. However, few individuals received exactly 7 per cent; rises ranged from zero to 15 per cent. Each was assessed on an individual merit basis. If there is to be a degree of unhappiness – which is virtually inevitable under adverse economic pressure – it is vital to keep the key individuals and the high performers happy.

Overall, the company has demonstrated just how much of the systems budget, and probably most systems budgets, can be cut – not without hardship and difficulty, but without reducing essential development or substantially decreasing user service levels. Although the process is not complete, cuts to date have made it possible to reduce the planned operating costs for the current year by 16 per cent and capital expenditure by 66 per cent. Just one item in his budget was increased – training.

Recharging systems may be consuming too much effort

An interesting example of one 'peripheral' activity, which is regarded as sacrosanct by many, is recharging for systems services. As one systems manager commented, "All recharging does is to cause resentment and endless time-consuming debate between me and my customers. Moreover, I was employing two people full-time to operate the recharging system and handle queries. After brief discussions with my customers, I discontinued it."

Refocusing on what really matters

A key to meeting the seemingly conflicting aims of satisfying new requirements and cutting costs is to concentrate on real business needs and to discontinue projects and activities that are unrelated to the immediate business priorities. This refocusing can prove of enormous benefit to the organisation, but it needs to be carried out as a systematic and ruthless exercise.

At Midland Bank, information systems are vital to the health of the bank. The pressure and initiatives to cut the costs of providing systems should not be confused with a failure to perceive their value. Efficiency in delivery is only one part of the equation. This is highlighted by the fact that, in the current climate, and with a fiercely competitive market, product innovation is an essential aspect of the bank's business, and systems are needed to support this innovation.

Focusing on the real business needs ought to be an obvious priority for any systems department. Time and again, however, the biggest gains come not from being more efficient in development, but from eliminating non-essential projects or projects that have little genuine impact on the real business requirements.

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The IT director at Midland Bank put it like this: "As an organisation, we have to ask ourselves, if we fail to do a particular project, will we stop lending money or taking deposits, or will the auditors qualify the accounts? If not, why do it – particularly now?"

A simple but effective technique for cutting peripheral activity was employed by the new IT director at the International Stock Exchange London. It achieved dramatic results. In January 1990, the Exchange had some 350 systems staff and a forecast 1990 development expenditure of £15 million. Even so, users were dissatisfied because most projects were running late and little of real value was being delivered.

His first action was to ask each development manager to list, for each project, the planned and forecast completion date, the budget, the amount forecast and spent to date, and the name of the business manager sponsoring the project. All projects that had no sponsor and that did not relate to the Exchange's core business – more than half the total – were halted, *even if they were virtually complete*. Following discussions with sponsors, priorities were set for the remaining projects in line with the needs of the business, and the resources of the department were allocated accordingly.

All projects should be reviewed, even those that are nearly completed

A year later, virtually all projects are on time, users are satisfied, and the number of staff has been reduced to 99 and the budget to £8 million. This was achieved partly by the re-organisation referred to earlier, but mainly by focusing on what really mattered to the business. This is perhaps an extreme example, but most systems departments have some projects which consume resources and for which no real business case has been made – or where a good case was originally made but does not stand up today. In effect, many systems departments are making bespoke suits for dead customers.

Setting priorities for new developments

Given tight constraints on overall resources, competition between projects, and a wish to allocate resources to those projects that have the greatest impact on the business, there is a need for a clear mechanism for evaluating opportunities. Of course, that has always been the case, but in times of recession, it is critical that the evaluation criteria reflect the current business climate. There may be an excellent case for a project in terms of cost/return, but it may simply be unaffordable, or it may have a high payback when the business actually wants a *fast* payback.

Project-evaluation criteria should reflect the current business climate

Midland Bank has adopted a very clear-cut and structured approach to this problem. It is based on two criteria – how financially attractive a possible project is and whether that project is for a commercially deserving business area. Financial attractiveness is a factored rating based on items such as internal rate of return, payback period, overall size of payback and risk. A commercially deserving business area is either one that is already delivering a high performance (based on return on equity) or one that could substantially improve its performance if the proposed system were developed and installed. These two criteria are used to form a 'priority matrix' (see page 9), on which proposed projects

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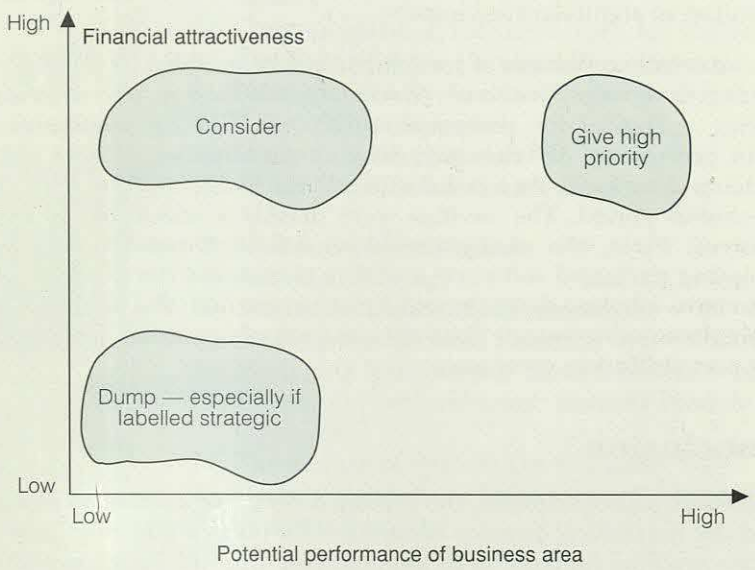
Proposed projects can be plotted and compared on a 'priority matrix'



can be plotted and compared. In addition, every new development has to have a business sponsor who has to argue the case for the project and take responsibility for the delivery of the business benefits.

Exploring other avenues

Some of the steps being taken to prune costs have longer-term implications, many of which are uncertain. The use of temporary contractors and outsourcing are cases in point.

More than half of the respondents to our survey said that they had substantially reduced the number of outside contractors. This cuts costs in the short term; in the long term, however, it fails to achieve what many financial directors are really seeking – a reduction in fixed costs. Fewer organisations are looking seriously at the case for outsourcing, although there are potentially significant savings to be made by this approach. A possible explanation is that many systems directors still see outsourcing as a threat.

Few organisations are considering the savings that can result from outsourcing

There may be good reason to shift the whole balance of corporate IT costs, whether these involve computer operations, development resources or networks. Hard economic times may be the trigger that causes managers to investigate the cost saving that can be achieved by outsourcing. However, managers should recognise that outsourcing is a strategic issue involving a long-term commitment. It should not be a knee-jerk reaction to a short-term problem.

Rationalisation is another way in which several organisations have made substantial savings. For example, Midland Bank cut the staffing levels for operating its data centres by 40 per cent over a four-year period, during which time output tripled. It adopted a 'utility approach' to the provision of computer services. As a result,

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the number of staff within the data centres fell from 1,500 to 900 while costs fell by around 25 per cent in real terms. In France, BFCE reduced the number of its data centres from 25 to 3, which resulted in significant savings.

An interesting example of rationalisation is provided by an engineering company that had previously adopted a two-supplier policy – Digital for technical work and IBM for commercial data processing. By changing to a single supplier, it was able to more than halve its annual expenditure of £2.5 million over an 18-month period. The savings were mainly attributable to two sources. First, the change could be achieved rapidly only by adopting packaged software, and this eliminated the need for an extensive systems development function. Second, the adoption of a single supplier meant that only one set of specialist technical-support skills was necessary.

Significant cost-saving can result from rationalising computer hardware

Conclusion

In a cold business climate, the finance director sets different rules, and the marketing director recognises that it is a different game. If the systems function is to take the role that all its proponents say it should, it has to be absolutely in tune with business realities. It cannot claim special privileges. It must respond, and be seen by the rest of the management to be responding, to the short-term needs of the economic situation. When the recession bites, the concern of most businesses is to improve their marketing and control their costs. These are both areas in which the innovative use of information can help. The systems department is the guardian of that information and can turn the recession into an opportunity to demonstrate its value. Responding to a recession is painful for everyone. Jobs and budgets must be cut, and plans put on ice. However, if the systems department is seen to be taking a lead, not only making its own contribution but also helping other managers to make theirs, the gap in understanding and credibility that so often separates systems from the rest of the business can be bridged.

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The Butler Cox Foundation

The Butler Cox Foundation is a service for senior managers responsible for information management in major enterprises. It provides insight and guidance to help them to manage information systems and technology more effectively for the benefit of their organisations.

The Foundation carries out a programme of syndicated research that focuses on the business implications of information systems, and on the management of the information systems function, rather than on the technology itself. It distributes a range of publications to its members that includes research reports, management summaries, directors' briefings and position papers. It also arranges events at which members can meet and exchange views, such as conferences, management briefings, research reviews, study tours and specialist forums.

Membership of the Foundation

The Foundation is the world's leading programme of its type. The majority of subscribers are large organisations seeking to exploit to the full the most recent developments in information technology. The membership is international, with more than 450 organisations from over 20 countries, drawn from all sectors of commerce, industry and government. This gives the Foundation a unique capability to identify and communicate 'best practice' between industry sectors, between countries, and between information technology suppliers and users.

Benefits of membership

The list of members establishes the Foundation as the largest and most prestigious 'club' for systems managers anywhere in the world. Members have commented on the following benefits:

— The publications are terse, thought-provoking, informative and easy to read. They deliver a lot of messages in a minimum of precious reading time.

— The events combine access to the world's leading thinkers and practitioners with the opportunity to meet and exchange views with professional counterparts from different industries and countries.

— The Foundation represents a network of systems practitioners, with the power to connect individuals with common concerns.

Combined with the manager's own creativity and business knowledge, membership of the Foundation contributes to managerial success.

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