Information Age

RESEARCH REPORT

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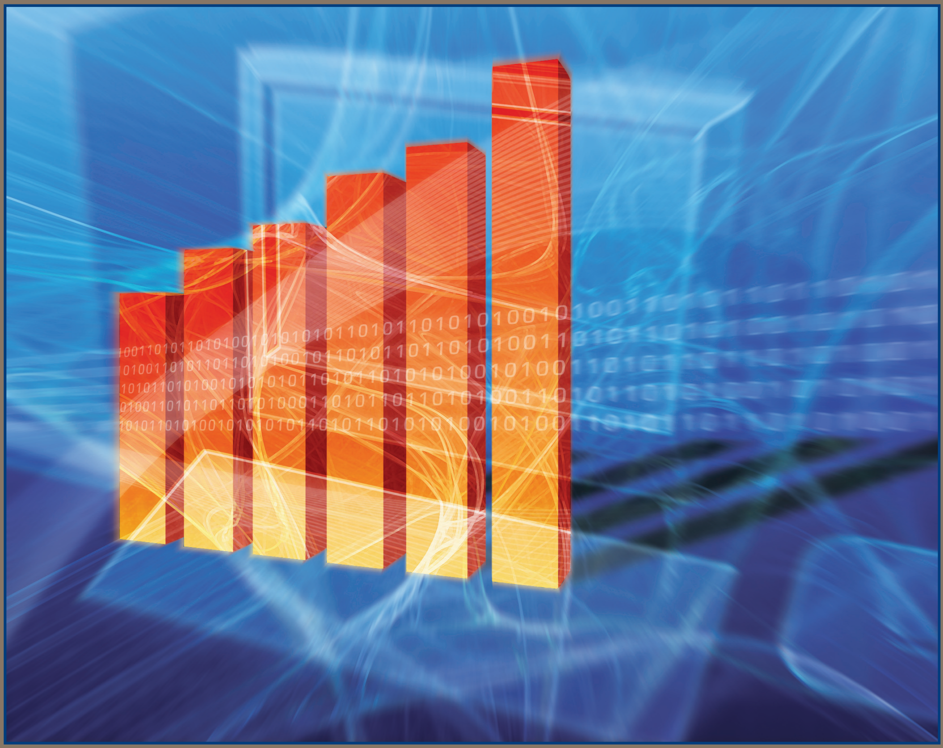

Return on technology

The economics of IT value creation

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Not achieving transparency of your IT spend?

We can help clear things up.

With spending on IT representing an increasingly large and strategic component of the overall cost base, establishing a clear view of the IT economics of your business is critical to ensuring that total IT costs are optimised.

They most often aren't. Which is where KPMG's IT Advisory practice comes in.

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For what IT's worth

Major barriers still prevent many organisations from maximising the business value they derive from IT

There is a fundamental question in business that is often asked but rarely answered to anyone's satisfaction – why don't we see more value from our investment in IT?

Organisations worldwide spent an estimated $3.1 trillion on IT during 2007, according to research group Gartner. And indeed, despite economic concerns, enterprise IT budget growth is still averaging 3.3% for this year, Gartner recently found when polling more than 1,000 CIOs. But the economics behind the business value generated by that spend requires a much closer analysis.

The evidence presented in this *Information Age* Research Report, conducted in partnership with professional services and consulting firm KPMG, suggests that there is a whole series of barriers that stand in the way of organisations reaping the full benefits of modern IT. Some are technical, but many of the most critical ones centre on business culture and the management of the IT function within the business.

MISALIGNED

One clear value choke-point is the lack of alignment between IT and the business. In many organisations, the IT function is still seen simply as a cost centre, an overhead. It supports the efficiency of core business processes through email, accounting, salesforce automation, call centres and so on, but it is largely separate from business development, let alone strategy.

What has become obvious in recent years is that unless organisations put in place structures to foster close co-operation, understanding and communication between the business and its objectives and the related IT capabilities needed to deliver those, many of these goals will never be achieved.

Where that has become accepted, organisations have tried to close the gap by establishing teams of business relationship managers that liaise between the two; in other cases, they have taken bolder steps and embedded parts of their IT function within relevant business units to establish deep understanding of the issues and challenges on both sides.

Of course, certain technologies are also seen as key. The application of agile and lean development techniques, for example, is ensuring that the applications delivered by IT fit closely with business requirements. And the adoption of service-oriented architecture is showing that those applications can be much more adaptable to changing business requirements.

In all cases, though, the aim is the same: to ensure that the investment in IT generates business value.

BUSINESS CHANGING IT

Not all IT is created equal, however. On the one hand, there is the 'run the business' aspect to IT – the systems that power key business functions. These are typically stable, often legacy systems, but they constitute an infrastructure that soaks up 70% to 90% of many IT budgets.

In contrast to that is the IT that has the potential to change the business – to establish competitive edge, to generate huge efficiencies, to drive innovation.

In recent years, the goal of many CIOs and IT directors has been to shift that balance: to take the proportion of IT spent on 'change-the-business' IT closer to 50%. And this Research Report shows a wide consensus that organisations are spending too much time, money and effort on IT that simply keeps the business ticking over and not enough on exploiting the potential for IT to deliver much greater business value.

Again, certain technologies are changing the balance, but so is the ability of organisations to leverage the global sourcing of IT services.

However, efforts to tap into IT's capability of delivering value in terms of new business initiatives can all be undermined by one simple factor: a lack of engagement by senior business management.

There are still many organisations where requirements for a new IT-enabled business function are set upfront by senior management and then 'thrown over the wall' to IT. In the absence of ongoing dialogue, and with the business constantly changing, the likelihood of the resulting application being what the business actually needs is slim.

Encouragingly, the results of this research show that attitudes are changing, and more business managers are engaging with IT because they see it as the basis for driving growth, profitability and market differentiation. And ultimately that will give a clearer – if still imprecise – answer to core questions about the value the business derives from IT.

Perceptions of value

Expectations for IT's ability to deliver sustained business value are riding high. But its full potential is still being limited by a lack of close alignment with business strategy

Are organisations investing in the right information technology – technology that is closely aligned to their business agenda?

The unpalatable answer to that fundamental question appears to be 'not often enough', according to research by *Information Age* in partnership with professional services firm KPMG. And, as a result, IT's potential to deliver value to the business is being vastly underexploited.

The survey, conducted through Information-age.com, asked 124 IT decision-makers to identify whether their IT project planning was directly aligned to the business agenda. Almost 40% said that projects were decided on individually, on an ad hoc basis, with no overall co-ordination between business and IT planning.

Although that represented the largest group of responses, about a third said that, while a high proportion of their projects are initially aligned to business plans, there is no further attempt to reprioritise and reset their relevance to the changing business agenda further down the road.

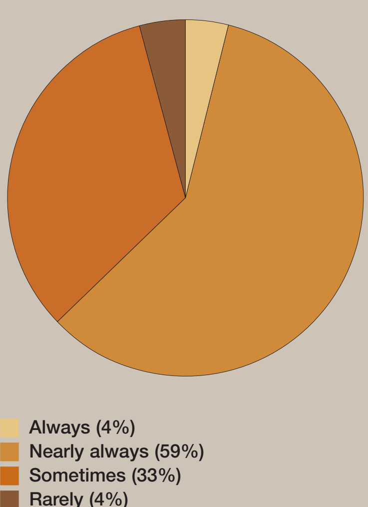
Indeed, only a quarter of interviewees could point to stringent portfolio planning and an alignment process.

One reason for that might be that business managers are not fully engaged with the creation of value from IT. The research found that only a third of organisations defined IT priorities and investments through joint consultation between IT and business management. A further 20% of IT departments are in charge of prioritising their own IT spend, taking input from relevant business units.

Interestingly, at almost one in ten companies – presumably small or mid-sized businesses – those IT priorities and investments are set by business management, without the involvement of IT.

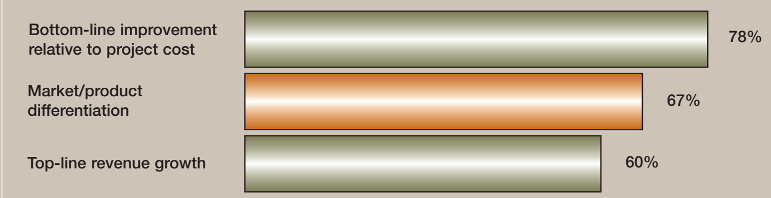
PAYBACK

How often do your organisation's IT projects deliver the expected business benefits?



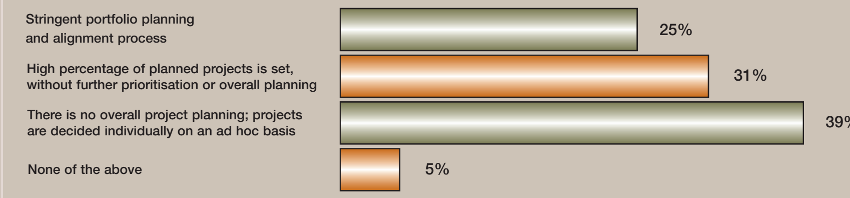
SUCCESS INDICATORS

What are the key indicators of project success for your senior business management?



PROJECT ALIGNMENT

To what extent is overall IT project planning (portfolio planning) directly aligned to business planning and needs?



LATENT POWER

A consequence of that patchy involvement of the business in those key decisions is that IT's potential looks particularly unfulfilled. Almost half of those questioned scored their organisation's record on exploiting IT for maximum business value at 40% to 60%. And only 12% put that ability to deliver value at above 80%.

The measure of what constitutes that value is widely accepted. Almost 80% of respondents regarded 'bottom-line improvement relative to project cost' as being the most important indicator of IT project success in the eyes of their senior management. That was ahead of 'market/product differentiation', which came in at 67%, and 'top-line revenue growth' at 60%.

Indeed, the survey was remarkably positive about the ability of IT to deliver expected business benefits. Almost 60% said that IT 'nearly always' delivered benefits, and there was an elite of five companies who said they 'always' fulfilled business expectations of value creation. (There was an equal number who said their IT projects never did!)

SEPARATE AGENDA

Nevertheless, a relatively small number make the distinction between the two 'missions' of IT (IT for running the business and IT for changing the business). Only 18% of IT management spend the majority of their time on new IT initiatives rather than IT operational issues. The norm was about 30% of time spent on 'change the business' initiatives.

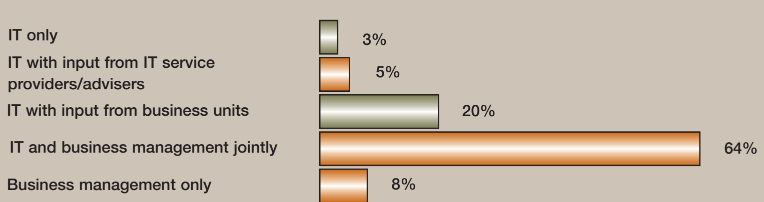
Most organisations do not have separate budgeting/planning discussions for spending on new projects versus ongoing IT operations. Only 23% said they have separate discussions for both.

That might point to a prevailing attitude by many in senior business management that IT is a pure support function rather than a means to creating business value.

But there is enough evidence to suggest that perceptions of IT as a force for business value have become commonplace. ⓘ

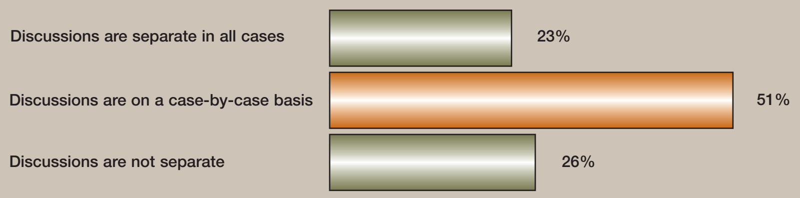
DEFINING PRIORITIES

Who defines IT priorities and investments within your organisation?



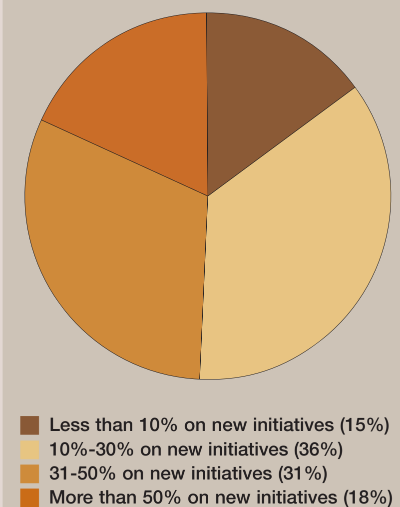
BUSINESS CHANGE

Does your organisation have separate budgets/planning discussions for spending on IT operations versus new projects?



NEW INITIATIVES

What percentage of your IT management's time is spent on new initiatives (versus IT operations)?



Releasing value

The pitfalls that prevent organisations from releasing the value of IT are becoming well understood

For all of its 40 years, IT is still a young, immature industry; even more so the management of IT within business. Bringing IT projects in on time, on budget and to requirements remains at best an imprecise science and at worst an ill-disciplined art form. Various estimates in recent years suggest that two-thirds of IT projects fail to meet their delivery dates, while half go over budget.

Business leaders may have become used to that, coming to accept that IT – like other activities such as construction and film-making – is subject to so many intangibles that 'slippage' needs to be built into the delivery formula. What they cannot abide, though, is when, after all the time, effort and money, the resulting applications fail to deliver the desired business value.

A 2007 survey by Dynamic Markets of 800 IT managers found that 41% of IT initiatives fail to show the expected value and return on investment. And today, one of the greatest challenges for both IT and the business is to ensure not only that the risk of project overrun is minimised but that each investment generates the maximum possible value for the business.

Industry analysts and business authors have waxed lyrical on this. Richard Hunter of Gartner, for one, makes clear the case: "The guiding principle is that the business value of IT is always, always, always measured in improved business performance as perceived by the business stakeholder. The CIO must position investment in IT as leading directly to improved business performance. Achieving this requires the CIO and the IT organisation to think differently, act differently and be different."

And that value has to be spelt out. "No enterprise in the 21st century runs for long without capable IT. Whether IT enables current operations or contributes to enterprise competitiveness, it is essential to success. But businesses produce returns on investment, not IT, and many CIOs struggle to communicate the value that IT produces for the business," he adds.

VALUE TRAPS

This is where the concept of 'value traps' comes in: pitfalls that stand in the way of the business understanding how IT investment improves business performance. Some of these traps are the aforementioned ability to deliver reliable, cost-effective services. But others are more related to an inability to establish tight linkage between IT and the business performance goals.

As numerous CIOs and IT managers have stated, the perception of the real value of IT is not going to come from the ability to deliver day-to-day services such as Internet access, email and payroll – the reliable delivery of those is a given. Rather, the appreciation of IT's contribution is built on initiatives that make tangible improvements to business performance.

Indeed, the expectations for IT are changing fast. According to recent work by the Economist Intelligence Unit (EIU), globalisation and increasing competition in markets worldwide are driving senior managers to demand a closer alignment of IT to business goals. The research indicates that 69% of senior IT and business executives expect the primary role of IT, traditionally seen as cost efficiency, to be elevated to that of enabling revenue growth within the next few years.

This expectation is most strongly held among CEOs and board members, 83% of whom are "wholly convinced" of this shift; IT managers themselves are a bit more cynical about this game-changing trend, with only 62% sharing the CEO's convictions.

The driving force behind this shift in priorities is shareholder pressure, the EIU reports. But the focus on justifying IT expenditure, combined with a growing understanding of IT at senior levels, is leading to the reappraisal of IT's role, as the potential to use IT to improve revenue generation is recognised.

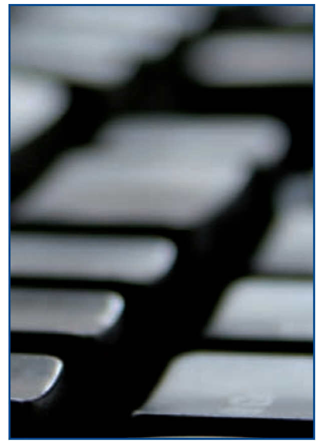
Indeed, when IT website CIO Insight recently canvassed its users on their pressing business goals for 2008, the top five aims were: improve alignment with business objectives; improve IT planning processes; improve project management capabilities; reduce IT costs; and improve ROI on IT spending. And those all map straight on to a single desire: for better management of the economics of IT value creation. ⓘ

About this research

INFORMATION AGE reader research is undertaken via questionnaires at www.information-age.com. Although the research may be sponsored by a supplier of IT products and services, it remains under independent editorial control. This survey on IT value economics was sponsored by professional services and consulting group KPMG.

Are you maximising the value of your IT spend?






We all know that the cost of IT increasingly makes up a large chunk of corporate spend but does it deliver value to the business? For too many organisations, the economics of IT and the real value delivered continues to be a mystery.

Experience and evidence from the field suggests that if an executive team can respond with a convincing "yes" to three key questions, they are in all likelihood maximising the contribution of IT to shareholder value creation. First, are they getting the most from business-as-usual IT spend? Second, are they maximising the returns on discretionary IT investments? Finally, are their IT investments truly focused on creating strategic business advantage?

From our work in helping clients maximise the business value of IT, KPMG have identified nine IT value traps that organisations regularly fall into. These traps, which often seem harmless at first glance, have the potential to destroy significant value and hold back an organisation's ability to exploit IT powerfully.

One of these traps is failing to realise that non-discretionary and discretionary components of IT spend require very different approaches. The former are day-to-day operational costs – management's focus should be on their containment and optimisation. The latter are investments – here, management's focus should be on maximising financial and strategic returns. Many companies don't make this distinction in their annual IT budgeting round, applying the wrong management focus to the wrong components. The resulting IT budget may well destroy more value than it creates. Other IT value traps relate to the design of the funding model for IT, the method by which investments are prioritised and the mechanisms involved in ensuring appropriate business-driven governance of IT.

By demystifying the economics of IT in your business and providing your company with the ability to escape or consciously avoid the IT value traps, KPMG professionals can help you maximise the value of your IT spend.

More broadly, KPMG helps CIOs and their leadership teams address all aspects of the CIO Agenda, from aligning IT with business needs, leveraging IT innovation, reducing IT risk and delivering solutions to the business.

KPMG is a truly independent advisor, providing objective client-side advice to the CIO and business executives. We work hand in hand with senior management, helping to make the right choices, at the right time, at the right cost.

For more information, contact KPMG's IT Strategy & Performance practice at cio-agenda@kpmg.co.uk

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Not achieving the impact your business needs from IT?
We can help you get traction.
IT is an increasingly critical driver for successful business change. It's also key to ensuring smooth, efficient day-to-day business operations. Very often, however, IT is pulled in too many directions at once. Urgency dominates strategic importance. Tactical initiatives compromise the broader IT landscape. Complexity increases and with it, the costs and risks of change. Project benefits fail to materialise. Management attention is diverted.
Ultimately, business confidence suffers. As does the business value from IT.
Our professionals can help you realign IT to focus on high-impact value adding activities, prioritise investments in the right areas, mobilise to deliver against commitments and help optimise business-as-usual services and costs.
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