

Executive Brief

Early Warning – Readyng Your IT Organization for Decelerating Economic Conditions

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Abstract

North American economic conditions are deteriorating, creating both risks and opportunities. IT organization operating environments will be more challenging in the year ahead. Specific actions in Q1 2008 will better position enterprise IT organizations to improve operating performance and focus scarce resources on business-differentiating projects. Investments in process improvement and financial re-engineering initiatives will decrease future operating expenses, optimize project selection and increase IT alignment with the business.

Introduction

Slowing economic conditions in the latter half of 2007 have been further aggravated by the continuing escalation of energy costs, a shrinking pool of business investment capital and a rising unemployment rate. Eroding consumer confidence indicators further suggest the US economy will continue to slow and may slip into recession in 2008.

This executive brief has been developed to help you consider the impact of and navigate today's potentially disruptive economic conditions. We have focused our analysis and recommendations on the issues we think offer significant opportunities for operational improvement and cost savings during this time of rapid change.

Current Operating Environment

Several IT industry trends that developed in 2007 will likely continue in 2008. The number of standalone software companies decreased significantly during 2007 as Oracle, IBM and others acquired a significant number of tier-two public companies. The business applications and BI markets were particularly impacted. Though generally greeted positively by the marketplace, these acquisitions will likely impact software maintenance economics in 2008 and 2009 as vendor strategies for consolidation play out.

Unlike previous periods of technology industry consolidation, this one predates the slowdown in economic activity, which creates the possibility for an interesting and not helpful period of upward industry pricing adjustments as the slowdown takes hold. Our experience in prior slowdowns indicates vendor pricing flexibility will increase for new license and hardware transactions during the slowdown period while flexibility will decrease for maintenance and routine expenses, particularly those driven by vendor-specific engineering staff.

In the IT staffing industry, the continuing commoditization of the staff augmentation business resulted in a large number of acquisitions, mergers and occasional failures during 2007 as margins decreased. The recent bankruptcy of Axium Chimes, creating chaos for thousands of contractors and hundreds of clients, may be a portent of future instability in the IT staffing industry. The lack of staffing vendor investments in training is creating a larger pool of IT augmentation resources with skills that are misaligned with current industry requirements.

Digging Beneath the Surface

In the last 10 years, many IT organizations have taken a hybrid approach to building enterprise IT budgets, combining funding for operating expense requirements for existing applications, infrastructure and staff with a prioritized list of future projects. Rigorous ROI calculations have been applied to new projects as the CIO sought funding for needed applications that were deemed high value by the business, while attempting to reduce stranded operating expenses for hardware and software maintenance. In some instances, important consolidation projects have been deprioritized in favor of expensive compliance projects. As a result, less focus was applied to elimination or reduction of stranded operating costs due to pushback from the business. Applying this approach during a period of eroding economics may expose the IT organization to a level of inordinate risk as budgets are trimmed “across the board.” Opportunities to consolidate and collapse legacy applications and infrastructure may be embraced more readily by the business during the slowdown period.

In our experience, early inspection of the entire IT budget, including pending projects, will achieve two time-sensitive strategic objectives:

- Identification of significant financial re-engineering opportunities, and
- Assured alignment of IT with the business as pressures increase across the enterprise.

The required level of review will differ depending upon a number of factors. Decentralized IT organizations with multiple decision makers and organizations undergoing transformational activities (mergers, acquisitions, divestitures) often benefit from a more detailed review. IT organizations subject to a higher degree of regulatory oversight or controls obligations (Financial Services, Healthcare, Telecommunications) often harbor significant cost reduction opportunities as well. Smaller organizations and those with highly evolved service delivery processes (ITIL, CMM) can be assessed more quickly, due in large part to the increased homogeneity of service delivery components (infrastructure and apps).

Illustrative Examples

Vendor activities surrounding hardware and software maintenance are often a rich source of cost reduction opportunities. Few organizations have the requisite staff available to routinely audit the service level requirements for each server, storage array, tape library, business application or tool set deployed in their environment to assure the appropriate level of support has been applied. Frequently we find vendors bill our clients for infrastructure components that are no longer in service or fail to adjust support levels as requested by our clients as infrastructure is migrated between development and production environments.

We also find frequent examples of software vendors billing for inappropriate seat levels on software maintenance. Software company end-of-quarter and end-of-year transactions often provide substantial cost reduction opportunities for higher discounts (lower costs) at transaction inception but later true ups often don't account for reductions in the total number of seats deployed, resulting in higher downstream maintenance costs.

Likewise, we find well meaning comparisons to "list price" and "discounts from list" mean little without reference points to valid market data. In a slowing marketplace, opportunities exist for renegotiating vendor discounts and buying vehicles. These need to be based on reference-point pricing

from across the marketplace rather than on “discounts from list.”

The intersection of rapidly increasing power expenses with hardware maintenance and software licensing costs in 2007 dramatically increased server and storage platform costs. Last year saw the advent of multi-core platforms which for the first time presented a “triple play” opportunity in the open systems arena. Removing three-year old server infrastructure and replacing with multi-core machines dramatically reduced server operating expenses (maintenance at a lower cost basis on a smaller number of servers), decreased power costs and significantly decreased software maintenance costs (operating system, database, tools). Sun has taken an industry leading position in this area with the introduction of more robust, less expensive hardware with the other host vendors trailing. Developing a comprehensive modeling approach can be time consuming from a data collection standpoint but the results are well worth the invested effort.

IT staff and contracting labor costs present a third area of opportunity. Pressure on IT staff costs will continue during 2008, driven by a decreasing pool of qualified candidates and escalating retention costs for high-value IT staff. Reducing complexity through the deployment of standards-based infrastructure and a consistent application portfolio will increase staff leverage models and reduce employee and contractor costs. Concentrating available “people dollars” on high-value staff will increase value to the organization and reduce the risk of losing key staff.

As staff budgets remain static or decline, the importance of well-documented IT service delivery processes increases exponentially. Staff reductions will have less impact on service delivery if processes are well documented. We find this to be of particular importance in the business continuity area. Focused investments in ITIL-based service delivery processes will drive cost efficiencies across the organization.

The Path Forward - Three Steps to Success:

Implementing a strategy to directly impact your current cost structure, ensure alignment with the business and refine your IT Human Capital approach is essential for operational success. Monitoring and measuring organizational progress will ensure long-term results and mitigate risk.

Step 1: Snapshot Assessment, Dashboard Monitoring

The most immediate results will be driven by snapshot or one-time assessments of IT budget and service-delivery components. Using a detailed approach to reviewing vendor costs, facility utilization, service-delivery sampling and overall project alignment will surface significant cost reduction opportunities that are often below the visible horizon of year-to-year budget planning. Snapshot results should provide the IT leadership team with sufficient information to divert or redeploy resources where necessary. Longer term cost reduction opportunities can then be prioritized on a benefits earned basis to determine whether resources should be shifted between ongoing or planned projects.

Visibility is key for the CIO during periods of rapid change. IT dashboards, though hailed and flailed at various times since the late 1990s, provide a well-focused view into organizational performance when deployed using straight-forward measures of high-value and high-volume service delivery processes. Excessive reporting complexity slows the delivery of results and reduces or eliminates dashboard value.

Maintaining a focus on high risk and reward areas (i.e., operating expense ratios, composite expense ratios and key staff retention metrics) that can be easily monitored is paramount. Snapshot results should be used to identify key dashboard metrics and to populate baseline data. Dashboard trends should be used as an IT executive guidance tool during budget discussions with the business.

Step 2: IT Alignment with the Business

Major changes in the business are more likely during economic slowdowns as internal capital is redeployed against a smaller set of initiatives. These changes present both opportunities and risks for IT as the business changes direction. Consolidation activities deployed during this period of change must be carefully correlated with the business to maximize results and avoid unintended service lapses.

We strongly recommend an enhanced IT project portfolio and PMO approach with strong representation from both IT and the business to analyze consolidation opportunities as the business shifts. The PMO should assess potential consolidation opportunities along three dimensions:

- Service Cost and Economy
- Service Quality and Effectiveness
- Time to Market (internal)

IT should resist an approach that aligns IT resources with individual business initiatives without prioritizing them across the business (perhaps led by a joint CIO-CFO or COO team). Tools for monitoring the IT project portfolio are essential during this period.

Step 3: IT Human Capital Strategy

IT human capital is by far the most complex component in the service-delivery equation, and as a result is most susceptible to volatility during periods of economic weakness. Your risk of recruiting activities directed at your staff will increase during this period. You can minimize the additional costs and risks associated with staff replacement problems with these straightforward steps:

- Increase the tempo and level of detail in communications to your staff and contractors. Distributing more information will reduce uncertainty and encourage support for overall objectives.

- Align annual objectives carefully with overall business strategy; avoid “business as usual” performance metrics and use the opportunity to reinforce the value of team performance.
- Increase the level across the IT organization of one-to-one career planning and personal coaching. Encouraging the development of leadership skills among senior team members is essential.

Conclusion - Act Now!

None of us can predict with certainty how economic conditions will evolve during 2008. Acting now to ready your organization for a more challenging set of market conditions will make life significantly easier later in the year and will improve the overall performance of your organization.

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About Systems Alliance, Inc.

Founded in 1993, Systems Alliance, Inc. provides business and technology consulting services to Fortune 1000 corporations, state and local government, higher education and healthcare clients throughout the Mid-Atlantic and Southeastern United States. Systems Alliance is headquartered in Sparks, Maryland and has satellite offices in Raleigh, North Carolina and Huntsville, Alabama.

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