

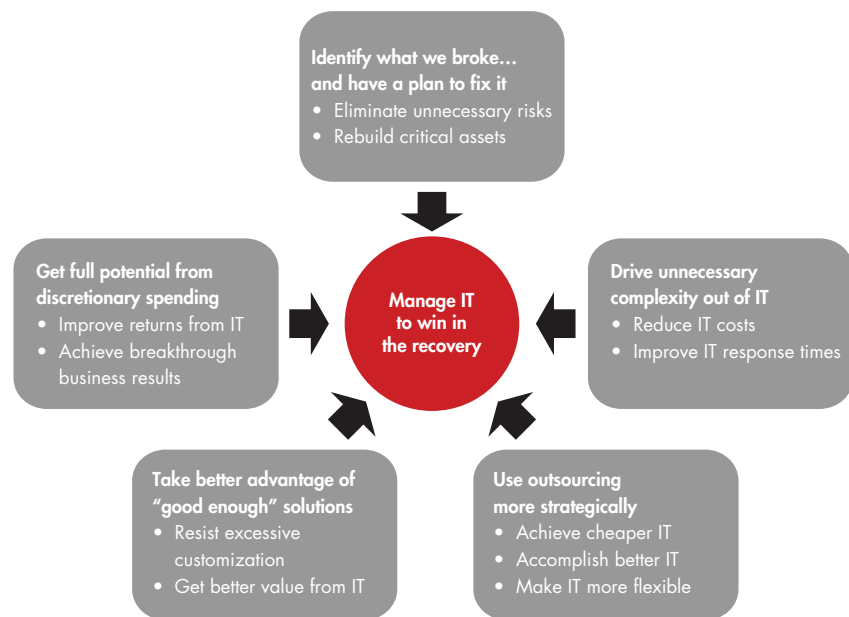


## Managing IT to win in the recovery

### CEOs need answers to these five questions

When the economy headed south in 2008, the reflex at most companies was to slash spending on information technology. While cutting information technology (IT) budgets may look like an unavoidable expedient for coping in tough times, the lasting effects can be profound. But now as the economy shows signs of recovery, companies that simply start to ramp up budgets risk introducing new problems that can plague their IT—and business—operations going forward.

To avoid compounding the error of cutting too much in the downturn by overspending during the rebound requires intervention from the very top of the organization. CEOs need to press their chief information officers for answers to five questions critical for managing IT to win in the recovery.



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### 1. Do we understand what we broke, and what is our plan to fix it?

Deep budget cuts during a recession do not merely freeze IT in place; they set off ripple effects that reverberate long after growth resumes. Decisions to stretch out hardware replacement cycles or postpone development of new software applications potentially expose the organization to unacceptable business risks. For example, when one leading consumer electronics company responded to the last major downturn by cutting its IT spend nearly in half, it emerged from a recession to discover that more than one-third of its mission-critical systems were running on technology no longer supported by its vendors, introducing significant business risks.

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Most companies are unaware of the harm caused by deferred maintenance. It is often only after the volume of business activity begins to rebound that the consequences of cutbacks manifest themselves as IT systems strain to handle higher volumes of transactions. Before signing off on new spending programs, it is critical to undertake a systematic inventory to reveal hidden business vulnerabilities or assets that were compromised by cutbacks. Addressing problems created during the downturn should be a top priority.

## **2. How do we get full potential from discretionary spending?**

Economic recoveries unleash torrents of pent-up demand in IT organizations and the business units they support to tackle new initiatives, build new systems and invest in new applications. The rationale to boost discretionary spending is usually couched as a competitive necessity, and these pressures are hard to resist. After all, for most companies more than 85 percent of their IT budgets are outlays that go simply to “keep the lights on.” That makes discretionary allocations a highly contested use of capital. Moreover, with each dollar of one-time new investment comes a less visible—but no less real—commitment to spend as much or more on ongoing operations, downstream maintenance and enhancements that begin immediately. Our experience confirms that these follow-on expenses can end up costing anywhere from two to 10 times the original outlay for years into the future.

Decisions about where to invest need to be made carefully and strategically, and a turn in the business cycle is precisely the time to ask the hard questions. Wise investments will target, or double down, on initiatives aligned with core business needs that yield competitive advantages. Resources available for discretionary spending are too precious to be dissipated across a broad range of secondary projects. At one financial services company, IT and business unit leaders sorted their IT investment priorities to favor capabilities that were truly “value creating,” enabling them to launch new products, for example, over those that were merely “value sustaining.”

## **3. How will we drive unnecessary complexity out of IT?**

Complexity builds up relentlessly as companies retrofit suboptimal systems, install patches to try to tweak performance and fail to fully integrate IT they added through mergers or acquisitions. The result is to slow down IT response times, pushing them out of synch with the business processes they are meant to support. Over time, the perpetual struggle to respond to urgent business needs results in adding much more to the base of legacy operations and systems than ever gets removed. Stripping complexity out of IT requires the organization, first, to stop adding still more IT systems that will only make the problem worse, and second, to begin consolidating suboptimal systems.

Bain & Company's experience has shown that much IT complexity results from unnecessary complexity in the business it supports. The surest way to eliminate business complexity is to take what we call a "Model T" approach. Companies begin by calculating what their cost structure would look like if they were to offer just one product. Then they cost out each new product variant as features are added back in. Companies that put themselves through this exercise typically find that costs do not rise in a linear fashion but rather jump sharply at break points where added complexity starts to strain against capacity. Knowing where those break points occur—and how to avoid them—can spell the difference between healthy profitable growth and subpar performance. Taking such a disciplined approach, for example, one financial services company scrutinized each of its application areas for opportunities to eliminate fragmentation and redundancy. As a result of the exercise, it was able to eliminate more than 40 "middleware" products that sat between the operating system and business applications, greatly simplifying vendor relationships and maintenance.

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#### **4. How will we take better advantage of "good enough" solutions?**

In search of a competitive edge, many IT organizations overinvest in the development of proprietary capabilities to customize solutions rather than make full use of acceptable off-the-shelf applications. This is a temptation that senior executives who make investment decisions should strenuously resist. In our experience, standard applications are the right solution for serving as much as 80 percent of a company's needs. The right question to ask is: Can we take advantage of vendor-supported software by buying more and building less?

The cost of giving in to the urge to customize can be high in two key ways that may not be immediately obvious. First, it can prevent the organization from taking full advantage of superior enhancements that can be achieved at lower cost. The initial release of a new software application may not accomplish everything the IT team hoped for, but the vendor is usually willing to absorb the cost of adding refinements in subsequent upgrades. Because version 2.0 improvements address the needs of many first-generation users, they will almost always be better than home-grown improvisations. When commercial upgrades are brought to market, the IT team's in-house modifications may have rendered them unusable by your organization, or require yet another intense round of costly customizations to make them usable.

Second, overreliance on in-house solutions development drains resources and diverts talent and energy from the 20 percent of applications where customization can give a business a huge competitive edge. These scarce resources should be reserved to develop systems that enable the business to provide superior customer service or product support that increases revenue, profitability or market share. For more mundane tasks, the better option to full customization

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is to take advantage of pre-packaged solutions from vendors that enable the organization to configure the software to meet its needs. Switching on features available in most off-the-shelf applications usually boosts performance as effectively, and at far lower cost, than investing in a one-of-a-kind upgrade. Our work with clients has found that they can more effectively meet 80 percent of their IT needs by buying off-the-shelf solutions and configuring them instead of building or customizing them.

**5. How do we make outsourcing more strategic?**

When business activity picks up, IT managers are apt to think first of strengthening in-house capabilities and staffing up to fill positions frozen or eliminated during the downturn. However, smart companies see business-cycle upswings as major inflection points for a fresh evaluation of their outsourcing strategies. They weigh how they can capture all three advantages that working with third party IT-service partners can provide—performing IT functions more cheaply, doing them better and doing more of them. In short, outsourcing shifts from a cost-cutting tactic to a strategic weapon.

Taking a fresh look at outsourcing may have unique advantages if the rebound from the recent deep recession proves tentative. It provides flexible capacity that enables the organization to ramp up to meet real changes in demand without having to increase fixed costs or commit capital to assets that sit on its balance sheets. And more companies will be looking to outsourcing partners to help them make the transition to cloud computing, which is redefining where IT work is done and for which having a comprehensive strategy will be essential.

Companies that shop for outsourcing services at the beginning of a cyclical recovery often discover they enjoy another edge: While their competitors are distracted with internal IT projects, they can take advantage of their enhanced bargaining power to lock in long-term service contracts on favorable terms.

By getting their IT organizations to provide answers to these five questions and to act on them, CEOs will get more out of their IT investments. They will also improve IT's ability to support the business in the recovery and be lean and flexible enough to sustain the benefits when the next downturn inevitably arrives. Finally, these questions—and the responses they elicit—can help repair the broken dialogue between business and IT that has plagued too many companies for too long.