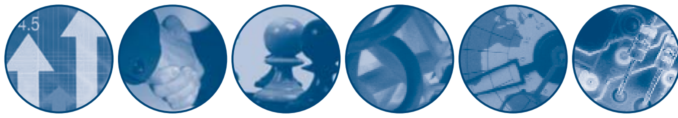

Update

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Achieving Enduring and Sustainable Cost Reduction

by Ron Blitstein, Director, Cutter Consortium Business Technology Strategies Practice

In response to economic downturns, it should come as no surprise that many companies turn to short-term cost cutting and/or choose to place big bets on business transformation efforts that may be premature. Often, short-term reductions are short-lived, while the transformative approaches typically underdeliver and cost materially more than expected.

As I work with clients and speak with colleagues across the globe, it is clear that the process of delivering meaningful, sustainable, and enduring cost reduction requires more clarity, focus, and action. IT organizations are almost always required to do more with less. So it is no surprise that IT budgets are always under scrutiny. Nor is it a revelation when levels of scrutiny become even more severe during periods of economic uncertainty. Today's financial climate continues to position cost reduction front and center on the agenda of CEOs, CFOs, and, consequently, CIOs. The pressure to reduce IT costs while maintaining service and making IT investments that will improve business efficiency and business outcomes is unrelenting. However, as we'll explore in this *Executive Update*, it is under unrelenting pressure that diamonds are formed.

Organizations continuously struggle to deliver discretionary requests and capital programs while reducing their "lights on" (nondiscretionary) cost of delivery. Many firms are long beyond cancelling subscriptions, reducing travel, limiting training, or elongating asset refresh cycles (aka "sweating the asset"). Some have taken more surgical measures to bring costs down, while others have resorted to carpet-bombing the chart of accounts. Regardless of approach, the question to ask is "Have today's organizations attacked the problem of cost so that reductions are enduring and sustainable, or have they merely kicked the can down the road?"

Understanding the linkage between capital programs, discretionary spending, and lights-on IT expenditures is critical. Investments made with capital or discretionary spending in one year invariably must be added to the baseline operating expenses in the years that follow. Figure 1 reflects the effect of a Year 2 transfer of costs into nondiscretionary spending. Additionally, it shows a frustrating truism: for most companies, lights-on nondiscretionary spending accounts for approximately 70%-80% of the IT budget. Worse, the top three components within this category — depreciation, labor, and license fees — are not particularly flexible.

To complicate matters, discretionary and capital investments represent the layers where organizations create new value; that is, increases in efficiencies or growth in revenues. Curtailing these activities to support growth in nondiscretionary spending not only compromises the business but erodes IT's value-for-money proposition. Redirecting nondiscretionary spending to discretionary spending in order to deliver greater business value is key. Successful CIOs know that they must progressively increase IT discretionary spending within a declining overall IT budget or, at the very least, achieve that on a unit-cost basis if business demand for services is accelerating.

The results and approaches used in previous rounds of reductions and downsizing represent a further complication for many organizations. In this scenario, firms

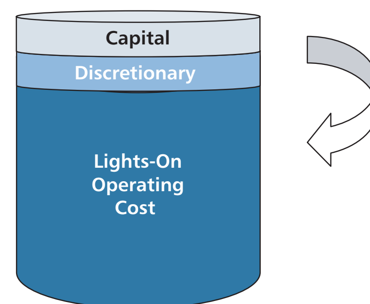

Figure 1 — Lights-on nondiscretionary spending accounts for approximately 70%-80% of the IT budget.

have already reduced IT cost, but it is unclear where they will derive their next batch of savings. In short, such firms are out of ideas. For some, their earlier decisions may require an urgent and unbudgeted remedy as risks previously considered remote now materialize. And for some organizations, their previous "cost reductions" were not sustainable and only managed to defer the required spending now coming home to roost.

As a former CIO and IT leader, I know this problem all too well. Over time, I have developed a way of thinking about cost that has helped me deliver declining unit cost on a predictable basis without cutting into organizational muscle, sinew, and bone. To be clear, there is no magic here. To some extent, it requires basic "blocking and tackling," but as anyone who has ever played (American) football can attest, this is a set of tasks that is harder to do well than it looks. The approach I recommend requires a crisp understanding of nondiscretionary cost, clarity surrounding the drivers of demand, and clean definitions of the services offered to the business. If you don't have those elements in place, you can stop reading now because you have a significant foundation to build. Sadly, most organizations assume that they have a solid understanding of nondiscretionary costs and demand drivers only to discover that their confidence is misplaced.

Assuming the prerequisites are set, consider an approach that brings significant value to cost-reduction initiatives: ACE (the letters stand for management actions to "accelerate," "consolidate," and "eliminate" certain items, processes, services, and so forth). As Table 1 shows, the approach is multifaceted. The degree to which you address all nine cells of ACE will determine how successful your organization will be in achieving sustainable cost reduction.

THE ACE COLUMNS

The column headers in Table 1 are fairly easy to explain:

1. **Accelerate.** The notion behind accelerate represents those items that you know are already working to reduce cost but have not been applied broadly to the enterprise. For example, this may include the limited deployment of a technology, process, or service. If you already know something is working on a small scale, it is time to accelerate deployment on a larger scale.
2. **Consolidate.** Consolidate reflects the savings opportunities that can be achieved by concentrating IT supply capabilities. This may range from ideas such as data center consolidation to focusing your buying power on fewer suppliers.
3. **Eliminate.** This is an equally straightforward concept. The eliminate column describes the items within the IT service catalog (i.e., objects of expenditure, nature of coverage, process of delivery) that will simply be

Table 1 — ACE Approach to Cost Reduction

Scope	Analysis of Cost Vectors	Accelerate	Consolidate	Eliminate
Entire IT Service Catalog	***Objects of expenditure:*** What do we buy? How much do we buy? Are we buying too much or too frequently? From how many vendors do we buy? Do we receive competitive pricing and terms for what we buy? Do we need everything we buy?			
	Nature of coverage: Do we buy support levels that exceed our need (platinum, gold, silver, bronze)? Do we provide support levels that exceed minimum requirements of the business? Are we paying for an upgrade path that we do not use?			
	Method or process of delivery: Are our work processes consistent? Do our work processes generate significant rework? How many places are our processes performed? What do our processes cost? Are our work processes recognized as being valuable by the business?			

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stopped. The fastest and shortest path to cost reduction is often achieved by the cessation of purchases for things or services, whether they are delivered internally or externally.

ANALYSIS OF COST VECTORS

With the column headers in place, now let's examine the rows of Table 1, which outline various questions organizations should ask themselves.

Objects of Expenditure

Most organizations do a fairly decent job of attacking their cost structure through the purchasing lens. These groups focus on their objects of expenditure — "the stuff they buy." They center their energies on driving out cost by reducing the amount of stuff they buy or reducing the purchase price they pay for that stuff. This is always good practice and should be a routine and regularly recurring activity. Clearly buying more than you need is wasteful and stopping such behavior allows for the harvesting of easy savings, especially if cost controls have not been refreshed in a while. After all, your vendors should bear *at least* their fair share of your cost-cutting burden. Consolidating vendors increases your buying power and provides negotiating leverage. When done well, this first stage of cost-vector analysis ensures that external costs are as lean as possible for a given level of demand. Unfortunately, many IT organizations focus exclusively on object of expenditure and spend little energy exploring cost-reduction opportunities that reside in the layers beyond (i.e., nature of coverage and method or process of delivery).

Nature of Coverage

Some IT organizations are more aggressive in their cost-reduction efforts. They move beyond asking "How many widgets do we need?" and "Are we achieving a superior cost per widget?" These groups instead ask themselves the question, "Are we buying coverage, or providing coverage, that exceeds the minimum requirements for our business?" This may require challenging the historical practice of buying platinum- or gold-level vendor support when silver or bronze may suffice. Many organizations pay extraordinary sums on software license fees and yet are several major releases behind in implementing the upgrades. Note that I am not advocating that IT not maintain its software licenses. However, if you are not going to implement the upgrades that your vendor provides, then realize there are other effective service alternatives that can provide your organization with software support at a materially lower cost.

Method or Process of Delivery

The most dramatic cost reductions are achieved by implementing structural changes. This requires shifting or creating lower-cost delivery models. Organizations that pursue this cost vector find significant improvement in labor costs that are achieved through better operating models, leaner processes, transformational technologies, and sourcing strategies. Savings derived by using this approach will frequently take longer to achieve than reductions achieved in the previous two layers of this cost-reduction model.

REINVESTMENT IS CRITICAL

Organizations using the approach described in this *Update* can surprise themselves and achieve more than sustainable ongoing reductions in nondiscretionary spending without sacrificing key IT capabilities. CIOs can successfully promote business goals and objectives by reversing the historic flow of IT spending. They can convert lights-on expense into increased discretionary opportunities and value. This is the diamond, alluded to earlier, that will help achieve and enhance business alignment and partnership. In short, CIOs can deliver sustainable cost reduction, higher quality, and make more discretionary funds available to improve business outcomes. My advice: make a diamond.

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Ron Blitstein is Director of Cutter Consortium's *Business Technology Strategies* practice and a Fellow of Cutter Business Technology Council. Mr. Blitstein's 30-year career includes extensive international operations experience and spans all aspects of information management. This includes technology strategic planning, program management, M&As, IT turnarounds, business process reengineering, software solutions development, ERP deployment, security/risk management, outsourcing negotiation, and network/operations management. As a senior technology executive, he has been a hands-on change agent working in companies across several industries, including office products, chemicals, medical systems and pharmaceuticals, and consumer products. Mr. Blitstein has held senior leadership positions at Xerox, Ohmeda, BOC Group, Pitney Bowes, and Revlon, in addition to providing consulting services at several *Fortune* 500 companies as Managing Director of IMprove Technology Advisors. His operating roles include direct leadership of global organizations based in the US, UK, Germany, South Africa, Australia, Japan, China, Singapore, and India. He can be reached at rblitstein@cutter.com.