

## Strategically Exploiting IT Financial Constraints

By Chris Potts



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As "Why You Shouldn't Have An IT Budget"

One of the many diamonds of wisdom that come from working with people running companies is that a corporate strategy needs a constraint or two. While the strategy sets the ambition and context for business decisions, constraints drive us to make them. Two things, however, are vital: a constraint must be genuine, not imagined or contrived, and people must know how to use it in ways that execute the strategy rather than undermine it.

With much talk of global economic challenges in the air, it's a good time to reflect upon what we've learned about the value of IT spending constraints to the success of the CIO's strategy. Some battening-down of the hatches seems inevitable, so let's make sure we turn this to our advantage. Even if the current economic concerns turn out to be misplaced, we can make sure the strategy wins either way.

What do we need everyone to remember about constraining IT costs? I've chosen two main themes.

First, that a CIO's departmental budget is rarely the same as the company's total IT spending. Constraining that budget is no guarantee that we are constraining the company's overall costs of IT because there are almost always IT expenditures in business unit budgets. So let's not focus on the IT department budget until we've understood the wider IT spending picture.

Second, that constraining IT costs in isolation from the business decisions that create them breaks the first principle of IT investment (which is that technology, on its own, delivers no value). IT budget constraints potentially impact all the people using IT to create business value, and all the business decisions that cause IT costs to exist. This is not like, for example, setting the marketing and sales budgets, where the consequences are mainly limited to marketing and sales.

So let's also understand, and utilize, the business causes of IT costs and the business impacts of constraining them in order to define how much to spend on IT.

## Defining the IT Budget

Rachael is the CIO of major transportation company, with 400 staff. Her departmental budget for this year is \$245 million, 17 percent more than last year. When times are tough, that seems wrong. Most departmental budgets are likely to be frozen or cut.

However, her executive colleagues know what is causing the increase; that Rachael's departmental budget is a variable proportion of the company's total IT spending; and that she consistently reduces her like-for-like budget (i.e., excluding the incremental impacts of new projects and of business volume growth).

Rachael is leading the corporate strategy for IT. Its promise is that the company will create maximum value from all its investments involving IT. That would still be the promise of the corporate strategy for IT even if there were no IT department.

The IT numbers that most concern Rachael and her colleagues are not her departmental budget and the specific range of IT services it covers, but the company's total IT costs. In particular, the two numbers they always want to explore are total cash spending on IT and the total cost of IT to profit and loss (P&L). Cash spending is the money that goes out the door, whereas cost to P&L is how much IT costs the profit of each business unit and of the company as a whole. The two numbers are always different and are usually managed by different people.

Elements of both IT numbers appear in several corporate, business unit and project budgets. Rachael's strategy relies on transparency of both the total numbers and the business decisions that cause them. So the last thing that she and her colleagues need is for people to hide IT costs, call them something else to get around constraints on IT spending, or call non-IT costs "IT." Besides blinding their strategy to the truth, such behaviors also undermine their tactics for using IT costs to influence business decisions and make nonsense of their IT benchmarking.

Because Rachael is transparent with her colleagues about her department's costs, their underlying causes and what those costs are paying for, her colleagues are equally transparent with her about the IT-related costs that come within their budgets. So they are all confident that they are working with the bona fide total IT numbers within an immaterial margin for error.

As a result, Rachael can prudently estimate that the company will spend a cash total of \$316 million this year on IT, 27 percent less than last year. While her departmental budget is increasing, total IT spending is expected to decline. However, Rachael also has to tell her colleagues that the total cost of IT to the company's P&L is expected to increase by 15 percent to \$285 million.

What are the main causes, her colleagues ask, of the movements in these numbers, and what can we do to reduce how much is spent on IT? This is where exploring the IT costs in isolation has to stop and the business context for those numbers must begin.

Rachael explains that the total cash spending on IT is mainly expected to reduce this year because the company is planning to invest less in business projects, and that a lower proportion of those projects' total business investment is planned to be spent on IT. However, she cautions, the actual total may be different from current provisions because many projects have yet to be initiated or even conceived.

### **Cut Spending the Right Way**

If the executives want to reduce total cash spending on IT what options do they have?

There will be some scope to prune total operational expenditure on IT. However, this will be paying for services that are used by the company's employees and customers to create value throughout the organization and beyond. These expenses are also covered by contracts with suppliers and IT employees. Furthermore, CIOs like Rachael have focused relentlessly in recent years on finding operational efficiencies and economies of scale.

More likely, the main room for maneuver will be in business projects involving IT (what we used to misguidedly called IT projects). Now, with everyone looking at the IT numbers they might be tempted to prioritize the IT costs within projects to meet a new, lower, IT total. This is the right process, but is looking at the wrong numbers.

The cash that executives are planning to spend on IT is only one element of the total project investment necessary to deliver the promised benefits. If the executives want to prioritize investments in projects involving IT they need to consider the entire project, not just the IT elements. They can choose not to invest in projects that promise the least bang for the business buck.

But a better process is to explore how they can achieve the same bang by spending less, or even nothing, by better exploiting existing systems. When they've finished, total IT spending within projects may be less or even the same, but the company will have the most productive portfolio of projects involving IT given the cash constraints they are working within.

Turning to the total IT costs to P&L, again, where is the room for maneuver? In Rachael's company these are increasing while total cash spending on IT is falling. This is because the costs to P&L are primarily caused by previous years' projects, not this year's. Capital investments in IT cause depreciation charges to P&L for years ahead, while many projects involving IT cause permanent increases in the operational costs for IT services. The best time to start constraining this year's IT costs to P&L was last year and before!

Therefore, to significantly influence future costs of IT to P&L we'd better start now. Constraining future IT costs to P&L needs to be an integral part of our project approvals process, solution designs, sourcing decisions and project management. If our projects portfolio is going to impact our future IT costs to P&L by more than we can afford, then we need to recraft the business changes that plan to exploit technology, with no loss of business value, so that the future IT costs stay within our constraints.

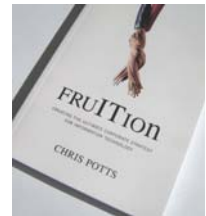
In constraining a company's overall costs of IT, the CIO's departmental budget is something of a red herring. Business decisions that cause the company to spend money on IT make the total IT costs what they are. If we get those decisions right then the most appropriate total IT spending, and then IT budgets, will emerge. That's worth remembering when we're looking at IT costs, whether times are hard or not.



Chris is a Corporate IT Strategist and CIO Futurist,  
an award-winning speaker and author of the business novel

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Write to him at: [cdpotts@dominicbarrow.com](mailto:cdpotts@dominicbarrow.com)

Visit his website at: [www.dominicbarrow.com](http://www.dominicbarrow.com)