Perspective

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1% IT in Aerospace And Defense *Reducing Costs While Increasing Capability*

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1% IT in Aerospace and Defense

Reducing Costs While Increasing Capability

The IT organization increasingly finds itself caught between opposing imperatives—being encouraged to provide greater support to the business while being ordered to cut costs. This is particularly true in the aerospace and defense (A&D) industry, where companies are turning to cost restructuring in the face of expected budget downturns while maintaining or increasing the demands on IT. In response, some IT organizations have achieved a step change in performance, delivering higher value to the business with a cost structure approaching 1 percent of revenue. An IT organization that can transform its operating model to act as both a cost center and a strategic enabler will be poised to manage not only the cyclicality of the present but the growth needs of the future as well.

Defense Budgets and Cost Restructuring Mean Lean Times for IT

Increased defense spending over the last few years has benefited the A&D industry. However, reliance on budget growth has often come at the expense of a focus on operating efficiencies. In the face of declining defense budgets, industry executives are now turning to cost restructuring to create (or protect) value. Many of those executives are focusing on the IT organization as a source for improving operational efficiency and reducing costs.

Meanwhile, IT has never been asked to do more. The modern IT organization is expected to respond to requests for significant service level improvements and meet the demands for differentiated services from an expanding range of stakeholders—all while staying current on a wide variety of technologies. Moreover, IT organizations are asked to explicitly prove their value-add contribution to the business.

This push-pull dynamic of interests risks generating a vicious cycle for IT. First, firms make spending cuts a priority, slash service levels, and put capability in the back seat to achieve targets. After a time, the business re-discovers the value of IT and infuses cash to address the most vocal complaints (which may not represent the most critical needs). Over time, IT budgets appear inflated once again and the demand for cost reduction renews.

The 1 Percent IT Organization

But IT can break out of this vicious cycle. Recently, we have seen IT organizations in leading-edge A&D firms achieve a step change in performance, delivering higher value to the business with an efficient cost structure approaching 1 percent of revenue. In contrast, many IT organizations within A&D still maintain a cost structure of 2.5 to 4 percent of revenue. The lean IT organizations have implemented a new, best-practice operating model that we call the 1 percent IT organization, which achieves the optimal balance of cost and capability to drive superior performance.

Becoming a 1 percent IT organization cannot be done with a “business as usual” approach; rather, the 1 percent IT organization transforms its operating model to become both a cost center and strategic enabler, poised to manage the budget cyclicality of the present and the growth needs of the future.

The design objectives for the 1 percent IT organization are clear:

- Radically reduce the costs for running the business
- Restructure the IT organization to retain only core, value-added capabilities
- Leverage the strengths and efficiencies of the IT market to deliver non-core services
- Make the IT function variable, providing transparency regarding costs, service levels, and performance such that the business can make informed choices.

Most important, the IT organization must meet these goals while maintaining a more affordable cost structure that is near 1 percent of revenue.

Easier Said Than Done

Most IT organizations adopt these objectives selectively, not comprehensively, and thus fail in the journey. Usually they try a piecemeal approach, targeting spending cuts or capability levels blindly, under pressure from corporate directives. This method is highly ineffective and counterproductive, typically depressing service levels and crippling the relationship with the business. Too frequently, the resulting profile is an IT function perpetually engaged in course-corrective programs to regain trust.

Operating model change does not come easily: The transformation is difficult, and implementing incrementally does not work. In our experience, best practices dictate that the 1 percent IT organization embark on a holistic program to reinvent its operating model, integrating three major components: strategic sourcing, demand management, and a thin model IT organization (see Exhibit 1).

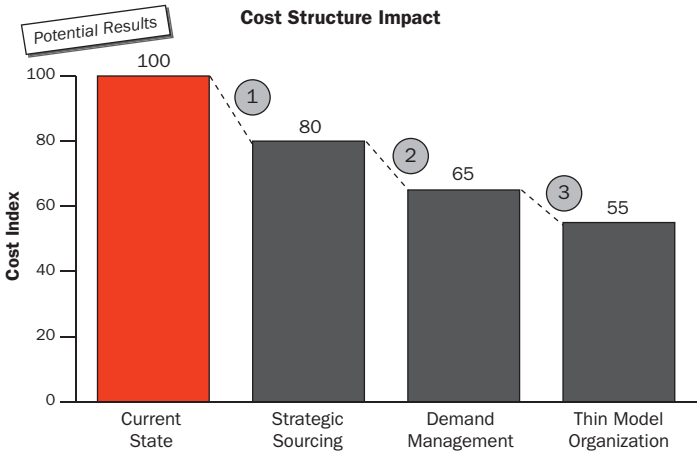
Transformation Component #1: **The 1 percent IT organization selects the right strategic sourcing strategy for its business.**

In our experience, one size does not fit all. The right strategic sourcing strategy mixes strong internal talent with appropriate capabilities from the service provider. Strategic sourcing of IT services is a proven cost-reduction measure. The art, however, is understanding with whom to partner, where to drive value, and how to manage the relationship—questions that have different answers depending on the context (see Exhibit 2).

Too often, IT organizations outsource to cut costs and realize some early savings benefits, but struggle to find value beyond the initial deal. A typical scenario: The IT organization demands favorable pricing to show quick savings; the outsourcer offers low fixed rates to enter into the deal but raises margins in subsequent project/change work to recover costs. Not surprisingly, incentives for continuous improvement vanish, the provider poaches talent to handle new opportunities, and an adversarial relationship ensues between customer and provider.

Exhibit 1

1 Percent Transformation Program Components and Sources of Value

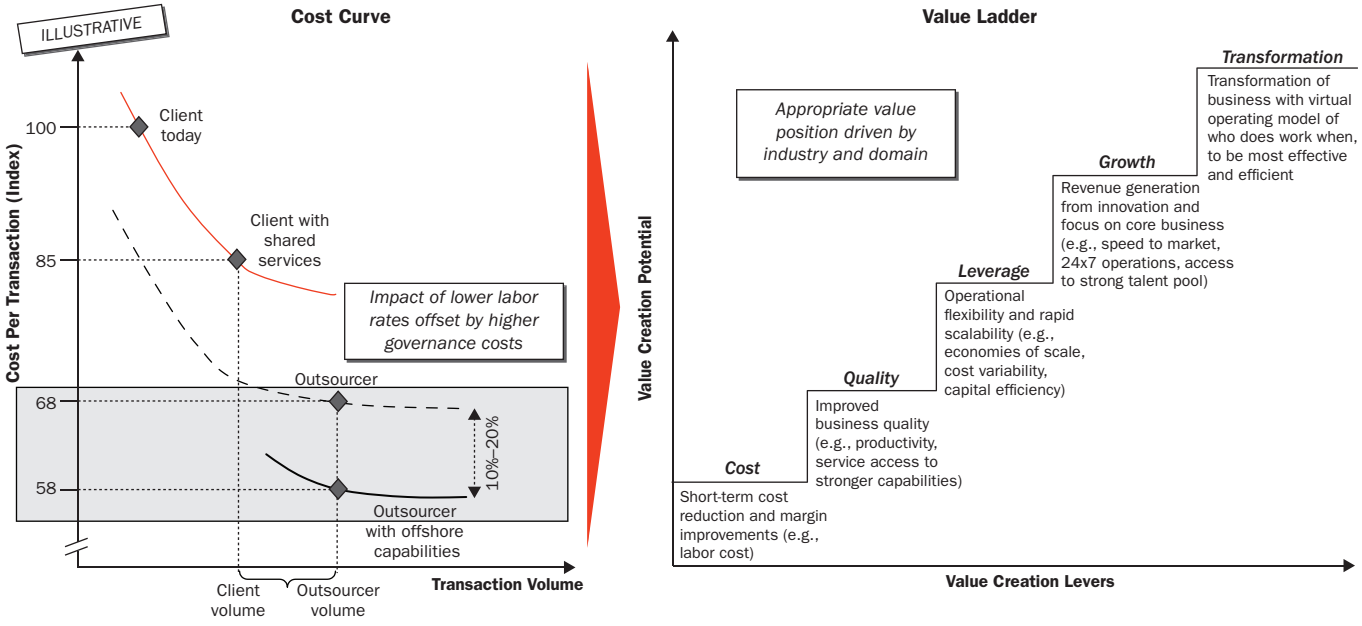


Major Sources of Value

1. **Strategic Sourcing (15–20%)**
   - Offshoring or near-shoring of non-informtion sensitive application maintenance and selected development activities
   - Infrastructure operations outsourcing
   - Adoption of vendor best practices and bundled contracts
   - Purchasing/efficiency scale of vendor consolidation
2. **Demand Management (10–15%)**
   - Discretionary spending caps
   - Service-level rightsizing (gold, silver, bronze)
   - High ROI hurdle investment processes
   - Role-based IT asset provisioning (e.g., codify who gets more expensive assets—BlackBerries, cell phones, laptops, etc.)
3. **Thin Model Organization (8–10%)**
   - Shared-service oriented
   - Thin layer IT management with geographic cost/skill leverage
   - Focus on a few key processes (e.g., governance, strategy, architecture)
   - Career path management

Source: Booz Allen Hamilton

Exhibit 2
IT Strategic Sourcing Cost Curve and Value Ladder



[1] Duke University/Archstone Consulting Offshoring Research Network 2004 and 2005 Surveys and Duke University/Booz Allen Hamilton Offshoring Research Network 2006 Survey
Source: Booz Allen Hamilton

In contrast, the 1 percent IT organization structures its relationships with a long-term view in mind. It recognizes that outsourcers need to be strategic partners, not just body shops, and uses an incentive-based, performance-driven model to capture ongoing value. The IT organization and provider agree upon a clear set of delivery and continuous improvement metrics, such that gains accrue to both parties. This produces a transparent set of motivators for the strategic partner to drive value into the relationship in a systematic, ongoing manner. In addition, the governance mechanism, metrics, and processes to manage the relationship are rigorously co-developed, with shared accountability for results.

Transformation Component #2: **The 1 percent IT organization builds a strong demand management capability to align priorities with the business.** The prevailing source of IT demand management takes on one of two forms: unregulated or poorly regulated. If it is the former, IT is viewed as a "free good," and consumption reigns. Projects are resourced despite the lack of a clearly defined business case or scope. The delivery system becomes clogged with unchecked demand. Speed to market is lost, as lower-value projects consume resources at the expense of initiatives with higher return on investment. As a result, IT is perceived as slow, with misaligned priorities.

The poorly regulated scenario, which is where many A&D firms find themselves, is sometimes even worse. Multiple governance forums and steering committees exist with no one entity to aggregate demand. Small projects tend to latch on to higher-visibility projects to gain priority. If one governance body rejects a project, the project managers appeal to others. Multiple demand sources, all categorized as priorities, overwhelm available capacity. In the end, IT can be perceived as overly bureaucratic—in addition to being slow—with misaligned priorities.

The 1 percent IT organization, in contrast, has a strong demand management capability build on four pillars: processes, performance measures, tools, and accountability (see Exhibit 3). Demand is effectively categorized, prioritized, and addressed at an enterprise level. Communication and transparency are fundamental: Informed debate serves to align the agenda between IT and the business. Senior IT managers aligned with different domains, such as manufacturing and supply chain, offer their perspective

on what those functions need and ensure that a rigorous process is in place for making those requests. Gated funding and approval processes ensure that IT pursues only the highest-value projects.

A strong demand management capability has a further benefit: cost savings. In fact, demand management can generate significant savings—as much as any supply or efficiency opportunity. The 1 percent IT organization uses four "quick hit" initiatives to deliver payback in less than a year and drop savings to the bottom line: "Turning off the spigot" to control discretionary spend; removing discretionary spend in the run budget; adjusting service levels to fit-for-purpose requirements; and instituting a provisioning model that codifies and enforces requirements for expensive digital assets.

Transformation Component #3: **The 1 percent IT organization uses a thin model client to run IT as a business.** The 1 percent IT organization has a singular mission: delivering high-value services at best-in-class costs. This means building core capabilities, moving non-core work outside the organization, and making every activity leaner—all with a thin layer managerial structure. This drives significant changes across the operating model, from supplier responsibilities (strategic sourcing) to business client behaviors (demand management). However, the most dynamic change is closest to the organization: IT management and staffing.

The 1 percent IT organization looks a lot different from the typical IT organization; namely, it is largely staffed in expertise-based functions (e.g., IT strategy, architecture, demand management, vendor management) versus utility-based roles (e.g., help-desk support, application maintenance). The proper governance, rules, and processes are put in place to ensure work gets done with a much smaller internal footprint.

This expertise-based staffing causes a dramatic shift in IT thinking. In the typical IT organization, most staff activity is directed to utility-based roles. Consequently, most of the executive attention focuses on these transactional elements. With the transformation to more expertise-based roles, IT executive focus shifts to more strategic, customer-centric interests. In turn, IT managers develop a more forward-thinking focus, taking on the role of business enabler. A trickle-down effect occurs in the organization: Priorities shift from operational, day-to-day firefighting to driving value for the customer.

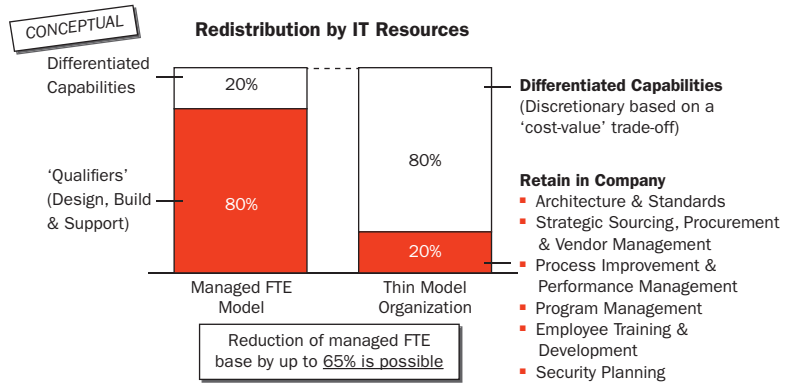
This change demands a different type of IT talent—individuals who are equally technologically savvy and customer aware. For mature, established technologies, seasoned managers who can handle large solution vendors or service providers are ideal. These managers drive delivery through well-defined supplier-management metrics (e.g., service level agreements, benchmarked prices, scalable cost/capacity) and

Exhibit 3
Demand Management Best Practices for the 1 Percent IT Organization

Framework	Typical Operating Condition	The 1 Percent IT Organization
I. Processes	▪ Varied processes by OpCo, governance forum, steering committee, and project phase ▪ Portfolio management confined to OpCo or steering committee levels and not widely communicated ▪ Limited visibility over major initiative pipeline and short-term resource planning	▪ Standardized processes for each project phase from demand capture to post-implementation review ▪ Active portfolio management at both the OpCo and enterprise levels ▪ Thorough communication of major initiative forecasting to facilitate long-term resource planning ▪ Rapid approval process for critical initiatives
II. Performance Measures	▪ Inconsistent use of or lack of performance measures ▪ Limited use of SLAs, project scoring mechanisms, and project phase reviews	▪ Standardized performance measures for resource base and demand ▪ Scorecard views, standardized business cases, and standardized performance reviews at each project milestone ▪ Rewards for joint Business/IT success
III. Portfolio & Project Management Tools	▪ Need for standard tools within and across OpCos ▪ Lack of a cross-enterprise project view throughout the project life cycle ▪ No linkage between incoming/forecasted demand and resource capacity	▪ Standardized tools for each step of the project life cycle ▪ Integration of tools to provide an enterprise view and monitoring capability ▪ Demand/supply balance facilitated by cross-enterprise tracking mechanisms
IV. Accountability	▪ No ultimate senior management level authority ▪ Tiered decision structure consisting of disjointed governance forums with little collaboration ▪ Emergence of steering committees with executive sponsorship as stand-alone governance forums ▪ Unclear project paths and ownership	▪ Ultimate authority of one forum ▪ Tiered decision structure that spans from corporate strategy level to implementation level ▪ Collaboration between governance structures ▪ Clearly defined decision rights and accountability

Source: Booz Allen Hamilton

Exhibit 4
Redistribution of Organizational Roles in the 1 Percent IT Thin Model Transformation



Typical Outcomes of the Thin Model Organization

- Elimination of high cost managed FTE model; adoption of a much less expensive managed services model
- Global Shared Service that focuses majority of effort on generating value and innovation to power the business
- IT resources empowered to think the "art of the possible"
- Internal focus on value-added activities creates better transparency within the business for the potential for IT to make a real difference
- Cost of mundane/'lights-on' work dramatically reduced by:
  - Eliminating the need to maintain by using many industry standard components
  - Reducing complexity
  - Finding the most efficient method
  - Leveraging the specialist expertise of partners

Source: Booz Allen Hamilton

vigilantly search for opportunities to lower costs through process standardization or technology refresh, as the case warrants. Correctly implemented, the new operating model radically reduces and redistributes the IT organization's talent (see Exhibit 4).

Conclusion

How do we recommend driving such an enormous transformation? Booz Allen Hamilton employs a four-phase approach (see Exhibit 5). In the first phase—baselining—we start by understanding total costs and tying them back to actionable budget items and performance data. Through this process, we baseline costs, labor effort, and workload drivers.

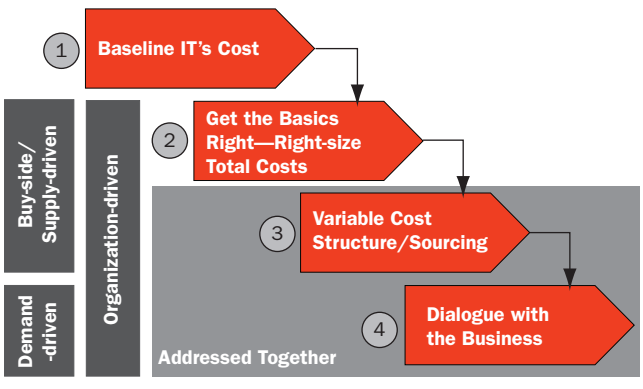
Following baselining, we apply meaningful benchmarks and best practices for each service area, founded on hard (versus soft) analytics. Because we thoroughly understand the best practices behind the benchmark, we can ensure their "fit." We do not co-mingle intangible benefits with hard dollar savings—we keep the qualifications out of the quantifications.

Once the "size of the prize" is understood, Booz Allen works with our clients to create actionable results with substantiated performance expectations. We provide a roadmap of "what" to do and quantify the expected results of pursuing an opportunity. Moreover, we help our clients define the metrics that will allow them to monitor actuals versus expected results.

If you want to pursue strategic sourcing, it is important to either 1) "clean up" the environment prior to handing it over to an outsourcer, or 2) understand the environment well enough that you can verify that the outsourcer has cleaned up the environment to the extent you negotiated. Booz Allen can not only help you understand the environment, but we can also help you manage the outsourcing process. Our Outsourcing Advisory Services have helped clients in many industries manage the various intricacies associated with the sourcing of complex environments.

Finally, Booz Allen will help you reach consensus with the business on service levels, support ratios, discretionary projects, and value projects. By helping you provide transparency regarding your operation's performance and communicating that performance in language the business understands, you establish the foundation for instant credibility, short-term cost reductions, and long-term continuous improvement.

Exhibit 5
Booz Allen Hamilton's Approach to IT Transformation



Source: Booz Allen Hamilton

About Our Aerospace and Defense Team

The focus and breadth of Booz & Company's Aerospace and Defense (A&D) expertise differentiates us among management consulting firms. Our team is focused on A&D—we do not hire or staff generalists. We provide a range of services from corporate strategy to business transformation.

Booz & Company's unique service delivery model combines expertise across both functional and industry lines. We can bring together an integrated set of expertise to address the complex issues facing senior management. For example:

- Our **Information Technology** team blends the understanding of IT from a business perspective and a technical perspective. Our IT experts bring a strategy-driven systems approach to work from the business needs back to the technical support requirements to ensure that the IT functions are focused on business requirements.
- Our **Organization and Change** team focuses on issues on the CEO's agenda related to organization model issues (e.g., corporate center, service delivery, business unit configuration, and change leadership challenges).
- Our **Operations** team focuses on helping clients build competitive advantage through the development of differentiating operations.
- Our **Strategy** team focuses on helping clients identify, build, and deploy market-driving capabilities to increase competitive advantage.

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