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The Magic Number
The IT Percentage that Reduces Costs and Increases Capability in Consumer Products

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THE MAGIC NUMBER

The IT Percentage That Reduces Costs And Increases Capability In Consumer Products

Executive Summary

The IT organization in many companies 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 consumer packaged goods (CPG) industry, in which a number of factors are leading companies to ask IT to do more with less: economic pressures, the fragmentation of the customer base, and shorter product life cycles. In response, some IT organizations have already begun to pursue lower cost structures, but blindly targeting a particular spending level may ignore critical business needs. Every company must determine its own "magic number"—the percentage of revenue that should be devoted to IT spending—and learn to build the capabilities it needs for growth while keeping costs down. An IT organization that can transform its operating model to act as both a cost center and a strategic enabler will be poised to meet future business needs.
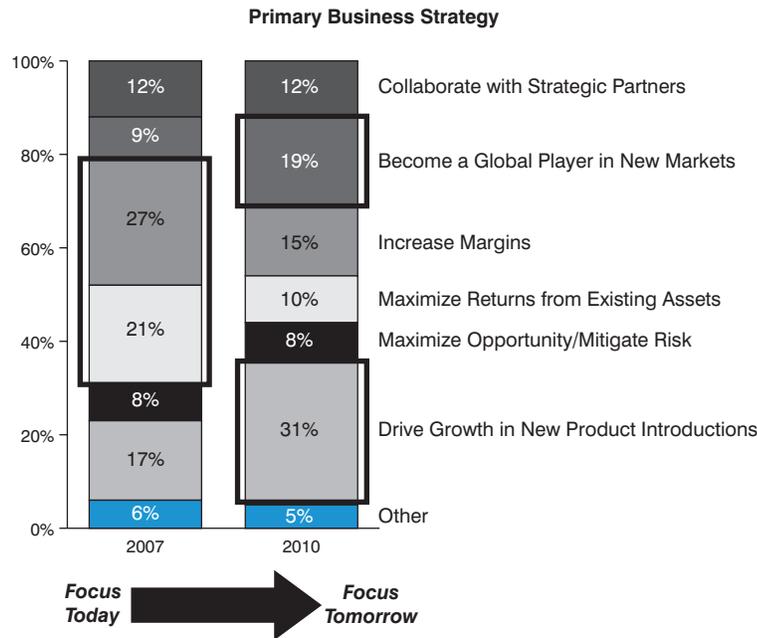
Consumer Product Trends Are Presenting a New Set of Imperatives for IT

In the face of economic pressures and intensified competition, CPG executives are turning to cost restructuring to create (or protect) value. At the same time, they are shifting their business strategies to focus on growth, including new product introductions and international markets. The implications are clear: IT must act as a source for improving operational efficiency and reducing costs today, while simultaneously adding flexibility for an unknown future (see Exhibit 1, page 2).

Today's IT organization is expected to respond to requests for significant service-level improvements and meet the demands for differentiated services from an expanding

Exhibit 1
Consumer Products Business Strategy—Today and Tomorrow

Primary Business Strategy

	2007	2010	
Collaborate with Strategic Partners	12%	12%	
Become a Global Player in New Markets	9%	19%	
Increase Margins	27%	15%	
Maximize Returns from Existing Assets	21%	10%	
Maximize Opportunity/Mitigate Risk	8%	8%	
Drive Growth in New Product Introductions	17%	31%	
Other	6%	5%	

Focus Today → **Focus Tomorrow**

Source: 2007 AMR Research/Consumer Goods Technology

range of stakeholders—all while staying current on a wide variety of technologies. Moreover, IT organizations are asked to explicitly prove their contribution to the business.

This push-pull dynamic of interests risks generating a vicious cycle for IT. First, companies make spending cuts a priority, slash service levels, and put capability in the backseat to achieve financial targets. After a time, the business rediscovers the value of IT and infuses cash into it 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 Streamlined IT Organization

But IT can break out of this vicious cycle. Recently, we have seen IT organizations in leading-edge CPG, food and beverage, and retail companies achieve a step change in performance. They are delivering greater value to the business with an efficient cost structure—between 1 and 2 percent of revenue. In contrast, many CPG IT organizations still maintain a cost structure of 2.5 to 4 percent of revenue. The lean IT organizations have implemented a new operating model that we call

the streamlined IT organization, which achieves the optimal balance of cost and capability to drive superior performance.

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

The design objectives for the streamlined IT organization are clear:

• Radically reduce the costs for running the business

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• Restructure the IT organization to retain only core, value-added capabilities

• Increase standardization to improve flexibility and global collaboration

• Leverage the strengths and efficiencies of the IT market to deliver noncore services

• Make the IT function variable, providing transparency regarding costs, service levels, and performance so the business can make informed choices

Most important, the IT organization must meet these goals while maintaining a more affordable cost structure.
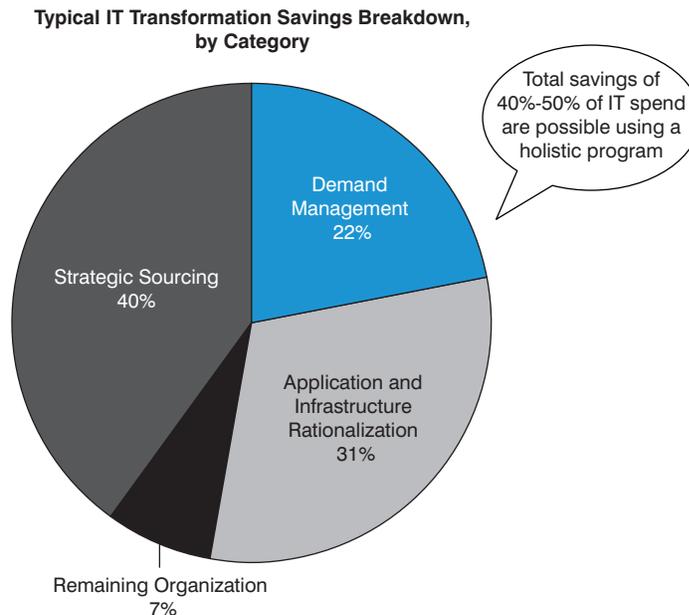
Easier Said Than Done

Most IT organizations adopt these objectives selectively, not comprehensively, and thus fail to achieve their goals. Usually they try a piecemeal approach, blindly targeting spending cuts or capability levels 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.

The challenge involved in transforming an operating model

is difficult, and implementing incrementally does not work. Many companies, for instance, choose to start by looking at their sourcing solutions, which can generate savings of 10 to 20 percent of IT costs. Based on our experience, however, the streamlined IT organization should embark on a holistic program to reinvent its operating model, integrating four major components: strategic sourcing, demand management, application and infrastructure rationalization, and a thin model IT organization (see Exhibit 2). Such an approach can generate savings of 40 to 50 percent, with demand management and asset rationalization often delivering

Typical IT Transformation Savings Breakdown, by Category

Total savings of 40%-50% of IT spend are possible using a holistic program

Demand Management 22%

Strategic Sourcing 40%

Application and Infrastructure Rationalization 31%

Remaining Organization 7%

Source: Booz & Company

quick wins that can fund the remaining initiatives.

***Transformation Component #1:* The streamlined IT organization selects the right sourcing strategy for its business.** The right sourcing strategy mixes strong internal talent with appropriate capabilities from the service provider. Strategic sourcing of IT services is a proven cost-reduction m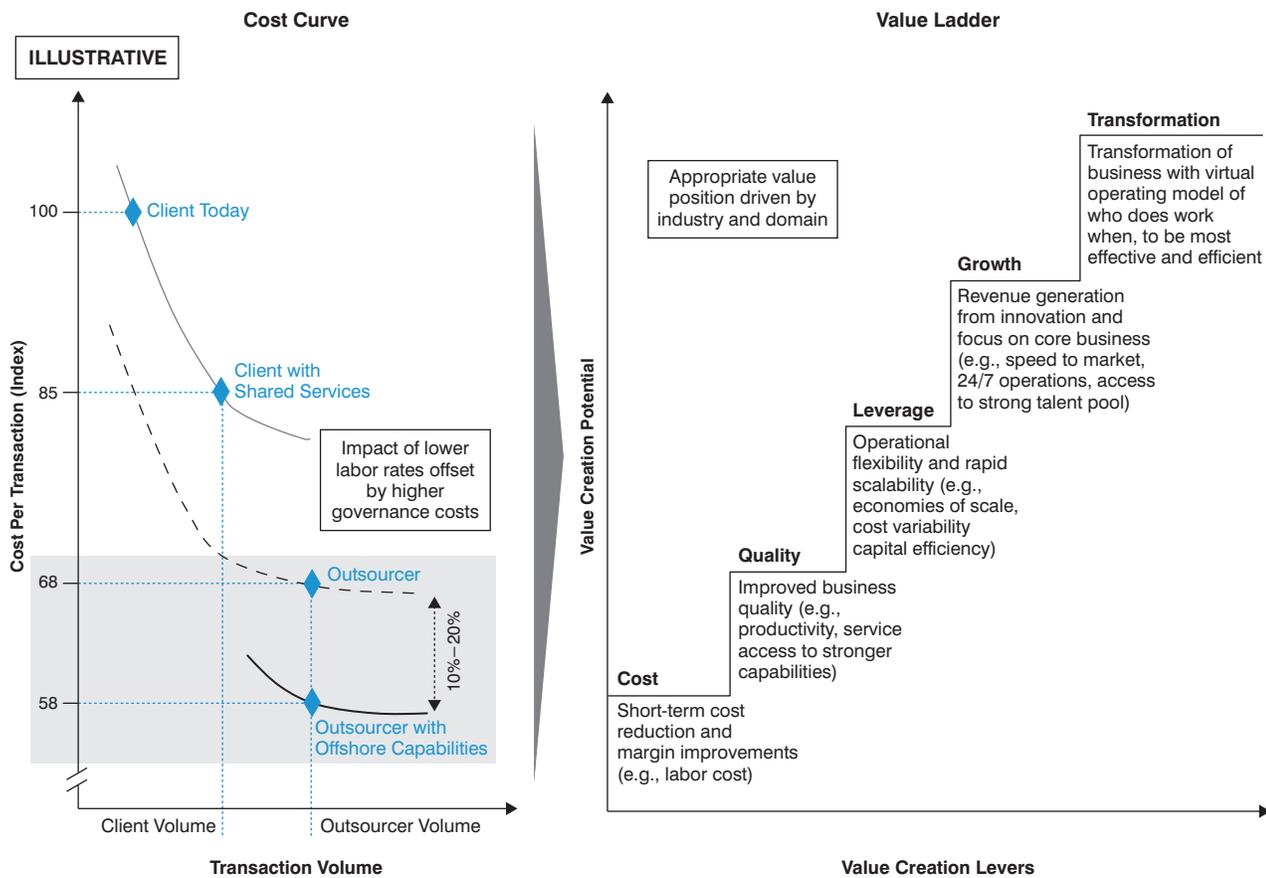easure. The art, however, is understanding with whom to partner, where to drive value, and how to manage the relationship—questions that have different answers depending on the context (see Exhibit 3).

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 projects to recover its 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.

In contrast, the streamlined IT organization structures its

Exhibit 3
IT Strategic Sourcing Cost Curve and Value Ladder

Cost Curve

ILLUSTRATIVE

Cost Per Transaction (Index)

100 — Client Today

85 — Client with Shared Services

Impact of lower labor rates offset by higher governance costs

68 — Outsourcer

58 — Outsourcer with Offshore Capabilities

10%–20%

Client Volume | Outsourcer Volume

Transaction Volume

Value Ladder

Value Creation Potential

Appropriate value position driven by industry and domain

Transformation
Transformation of business with virtual operating model of who does work when, to be most effective and efficient

Growth
Revenue generation from innovation and focus on core business (e.g., speed to market, 24/7 operations, access to strong talent pool)

Leverage
Operational flexibility and rapid scalability (e.g., economies of scale, cost variability capital efficiency)

Quality
Improved business quality (e.g., productivity, service access to stronger capabilities)

Cost
Short-term cost reduction and margin improvements (e.g., labor cost)

Value Creation Levers

Source: Booz & Company

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relationships with the long term 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 on a clear set of delivery and continuous improvement metrics, with gains accruing 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 streamlined IT organization builds a strong demand management capability to align priorities with the business.** The prevailing source of IT demand management takes 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 being slow and having misaligned priorities.

The poorly regulated scenario, which is the reality for many CPG companies, is sometimes even worse. Multiple governance forums and steering committees exist, with no single entity to aggregate demand. Small projects tend to latch onto 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 and having misaligned priorities.

The streamlined IT organization, in contrast, has a strong demand management capability built on four pillars: processes, performance measures, tools, and accountability (see Exhibit 4, page 6). 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 and business managers propose projects based on business needs and ensure that a rigorous but practical process is in place to review 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 streamlined 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 spending; removing discretionary spending 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 streamlined IT organization rationalizes the technology environment to reduce complexity and add flexibility.** With complex business operations (e.g., product development, manufacturing, distribution, sales), multiple partners, globalization, and merger activity, consumer product IT environments are often characterized by localized applications, infrastructure, and data that increase costs and inhibit collaboration. The streamlined IT organization promotes strict standardization, enabling global consistency, improving outsourcing options, and providing a platform for future technology, all while reducing costs.

As a first step, applications and services should be categorized as mandatory or discretionary, considering regulatory, customer,

Exhibit 4
Demand Management Best Practices for the Streamlined IT Organization

Framework	Typical IT Organization	The Streamlined IT Organization
I. Processes	• Varied processes by operating company, governance forum, steering committee, and project phase • Portfolio management confined to operating company 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 operating company 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 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 and Project Management Tools	• Need for standard tools within and across operating companies • 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 & Company

company, and employee needs. Discretionary areas should be examined carefully, using objective cost-benefit analyses to identify opportunities for simplification and rationalization. Companies should optimize the remaining applications and services by considering more efficient options and varying service levels, leveraging global capabilities such as outsourcing.

In addition, there are a number of benefits to standardizing and consolidating hardware that is not required locally. Doing so reduces maintenance, including routine upgrades, break/fix, data room costs, and personnel. Companies should also consider virtualization, which entails executing multiple operating systems and applications on the same computer. This reduces costs while adding layers of redundancy to CPU and storage, as well as integrating capacity scaling.

Transformation Component #4: **The streamlined IT organization uses a thin model to run IT as a business.** The streamlined IT organization has a singular mission: delivering high-value services at best-in-class costs. This means building core capabilities, moving noncore work outside the organization, and making every activity leaner—all within a thin 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

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closest to the organization: IT management and staffing.

The streamlined IT organization looks a lot different from the typical IT organization; specifically, it is largely staffed in expertise-based functions (e.g., IT strategy, architecture, demand management, vendor management) rather than utility-based roles (e.g., help-desk support, application maintenance). The proper governance, rules, and processes are put in place to ensure that work gets done with a much smaller internal footprint.
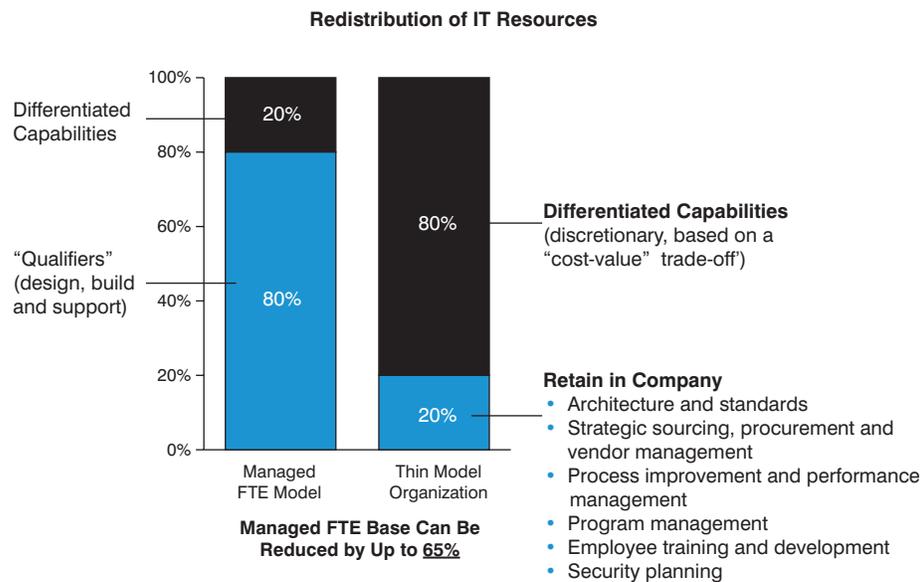
This expertise-based staffing causes a dramatic shift in IT thinking. In the typical IT organization, most staff activity is in utility-based roles. Consequently, most of the executive attention focuses on these transactional elements. With the transformation to more expertise-based roles, IT executives can shift their focus to strategic, customer-centric interests, 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 technology savvy and customer aware, trained to think in the art of the possible. 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 vigilantly search for opportunities to lower costs through process standardization or technology refreshment, as the case warrants. Correctly implemented, the new operating model radically reduces and redistributes the IT organization's talent (see Exhibit 5). The thin model IT organization minimizes the cost of everyday work by reducing complexity, increasing efficiency, and leveraging its partners' specialized expertise.

Exhibit 5

Redistribution of Organizational Roles in the Streamlined IT Thin Model Transformation

Redistribution of IT Resources

Differentiated Capabilities

"Qualifiers" (design, build and support)

Managed FTE Model — 20% / 80%

Thin Model Organization — 80% / 20%

Managed FTE Base Can Be Reduced by Up to 65%

Differentiated Capabilities (discretionary, based on a "cost-value" trade-off')

Retain in Company
- Architecture and standards
- Strategic sourcing, procurement and vendor management
- Process improvement and performance management
- Program management
- Employee training and development
- Security planning

Source: Boox & Company

From Idea to Reality

The most effective approach to such an enormous transformation has four phases: strategy, scoping, design, and delivery.

The strategy phase provides the necessary groundwork for success. It requires the IT organization to truly understand the company's business strategy and use it to determine its own objectives—whether reducing cost, improving effectiveness, ensuring flexibility, or driving innovation.

With a vision defined, the scoping phase begins by conducting a thorough baseline analysis of the IT organization, including costs, capabilities, and assets. It is crucial to break down IT spending into its major categories, as this provides an objective set of data to guide decisions, build business cases, prioritize initiatives, and better quantify savings. IT organizations can then assess their baseline costs and capabilities against the industry standards: Doing so allows them to identify where they might find savings and to highlight gaps in their capabilities. The final step of the scoping phase is to develop an initial road map, identifying where there is a compelling need to act and building stakeholder support, while simultaneously preparing an overview to define what needs to change, when, and at what cost.

Once the IT organization understands the potential for improvement—whether in terms of costs that can be cut, processes that can be improved, or both—it is ready to move on to the design phase. This entails drawing up detailed project plans for each initiative, including change management, communication, and risks. In addition, the IT organization must define what metrics will confirm that it is reaching its performance goals.

Finally, to deliver on the potential of this transformation, the IT organization must work closely with the business, reaching consensus on areas of impact such as strategic investments, discretionary projects, service levels, and support ratios. By increasing the transparency of the IT organization's performance and communicating in language the business understands, IT can establish the foundation for improved credibility, short-term cost reductions, and long-term continuous improvement.

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