"Slimming down a workforce in difficult times may seem inevitable, but there is always a danger of throwing out babies of strategic value with the bathwater"

—Financial Times: Don’t throw IT baby out with cost-cutting bathwater, December 3, 2008, by Alan Crane.

Tough times. Tough decisions.

Cut spending. Accelerate revenue growth. Decrease dependence on capital. These are just some of the directives leveled at management during these turbulent economic times. For IT executives, this burden often falls disproportionately on them.

While cost cutting may be critical to the health—or even survival—of some organizations today, casually making IT spend cuts can lead to unmet goals, unacceptable performance, and risk and control issues. However, leading organizations often differentiate themselves by adopting approaches that are well-planned, balanced, and take care not to overreact to cost reduction pressures. They ask themselves questions such as:

- Are our cost-cutting actions overly zealous, resulting in unacceptable risk and control exposures?
- Will we be able to deliver on critical business priorities?
- How will we manage tomorrow’s growing backlog of unsatisfied IT demand if we turn it away today?
Why do cost-reduction programs fail?

According to a 2007 KPMG survey* of more than 400 companies worldwide, 9 out of 10 cost-reduction programs failed to achieve their objectives—and those companies that managed some gains enjoyed only short-term benefits. Key pitfalls identified in the survey included:

- **Unclear cost drivers.** Companies need more insight into what drives costs in their business to ensure that cost-cutting is targeted at the right places and that the success of cost management initiatives is properly measured.

- **Overly cautious cost strategies.** Companies often pick the easy options for cost initiatives, rather than ones that may yield greater savings. While budget and head count reductions provide short-term cost savings, reducing complexity and improving process efficiency can yield significant and lasting benefits—but only if those efforts are conducted rigorously.

- **Cost discipline not embedded in a company’s culture.** Every person within an organization has a role in improved cost management, but too often, responsibilities are unclear, and employees understandably can feel threatened by change. A clear strategy and open communication are vital to the success of cost-cutting initiatives.

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*Rethinking Cost Structures—Creating a Sustainable Cost Advantage, KPMG International, 2007*
The wisest cuts

IT executives responding to a cost optimization mandate should consider this an opportunity to reposition their organization’s IT function for the long-term. By taking a portfolio view of cost-cutting initiatives—balancing quick-fix, tactical actions with more structural, growth-sustaining cost management approaches—an enterprise may be better situated to weather economic downturns and seize opportunities to drive business value.

IT executives can draw on their cross-functional insights to take a lead role in the cost optimization charge. However, the process should start carefully with a fact-driven dialogue with key business stakeholders. This action will set the stage for longer-term structural changes by:

- Redefining IT’s value propositions
- Establishing trusted, beneficial relationships with business stakeholders
- Improving IT governance and overall operating models to deliver greater business value

IT can play an important role in enhancing the value and agility of a business in change. Studies have indicated that more value is created when IT participates early in important business decisions. The collaboration between business and IT leaders is critical to enabling good communications, leveraging key IT perspectives and innovations, aligning goals, and developing and maintaining mutual trust. As a result, the organization will benefit from the ability to better leverage IT to deliver business value.

Organizations that do not seize the opportunity to leverage the business value inherent in IT could find that they need more resources, time, and funding to comply with regulations in the coming years. They could also forgo opportunities to achieve appropriately risk-adjusted results in response to their investments and in fulfillment of their goals.

When faced with a cost-cutting edict, some IT executives look too quickly at making across-the-board cuts. Using a solid fact-based approach and input from key business stakeholders, IT is better equipped to identify projects that are no longer aligned with business priorities as well as those that may be cut or deferred.

It may also be worth revisiting formerly rejected strategies, such as alternative sourcing or the rationalization of applications and infrastructure. Changes within an organization or budgetary concerns may now make these discarded options more desirable.

“It is] far better to eliminate those projects which are going nowhere, which had failed to progress as planned or which could no longer be deemed business critical… and leave yourself with just a core IT portfolio. When you consider the scale of some businesses’ IT investments, the savings could run in the millions.”

—Edgidio Zarrella, Global Leader of IT Advisory Services, KPMG
Primary value levers

In light of the current economic uncertainty, focusing on the “levers” that drive IT is important to determine the current and long-term business value. KPMG has identified four primary value levers that can help IT executives manage IT spend and enhance IT’s contribution to shareholder value:

- **Business Alignment.** Align IT investments with key business priorities.
- **Operational Efficiency.** Reduce the cost of providing IT services.
- **Operational Effectiveness.** Improve business performance through IT.
- **Capital Efficiency.** Improve the business’ return on capital.

Tactical versus structural approaches

Senior management can get a clearer picture of how IT can better support the bottom line by further examining these four value levers—in terms of both tactical and structural approaches. We define tactical approaches as those that can provide quicker returns with smaller investments and are often within the control of the IT organization. However, the value derived is typically difficult to sustain. Structural approaches, on the other hand, strive to deliver more fundamental and longer-lasting changes to processes, systems, metrics, or organization. They may require more sizable investments, take longer to implement, and may necessitate involvement of key business stakeholders. But the value produced through these structural changes is typically more sustainable.

**Improving IT’s impact on shareholder value**

1. **Business Alignment**
   - Align IT investments with business priorities
   - Increase Operating Profit (Net, After Tax)
   - Decrease Operating Expenses
   - Reduce Operational Risk
   - Increase Revenues
   - Reduce IT Expenses

2. **Operational Efficiency**
   - Reduce the Cost of Providing IT Services
   - Reduce Fixed Assets

3. **Operational Effectiveness**
   - Improve Business Performance Through IT
   - Reduce Capital Utilization
   - Reduce Working Capital Demand

4. **Capital Efficiency**
   - Improve the Return on Capital Deployed
   - Improve Deployment of Capital
Taking Action in Turbulent Times

Business alignment

**Tactical**
- Shut down or defer initiatives not aligned with top business priorities
- Re-scope initiatives to essential requirements
- Stop working on demand that has bypassed formal approval
- Halt projects lacking business commitment or involvement

**Structural**
- Enhance demand management mechanisms
- Rationalize redundant investments, solutions, and operations across business through re-use, sharing, and common approaches
- Invest to accelerate implementation of strategic capabilities
- Establish governance mechanisms to identify, encourage, and enforce businesswide collaboration and sharing

Operational efficiency

**Tactical**
- Cut non-critical enhancements such as reducing contractors and in-house staff
- Cut service levels
  - Reduce service delivery staff and contractors
  - Reduce capacity/defer capacity upgrades
- Analyze third-party work orders to ensure accuracy and compliance with rates, refunds, penalties (e.g., sourcing, assets, energy)
- Evaluate maintenance and service agreements
- Tighten and enforce policies for cell phones, virtual and onsite meetings, and training
- Accelerate contraction for early retirement and project completions

**Structural**
- Develop alternative sourcing strategies
- Rationalize contractor relationships
- Consolidate and standardize application and technology platforms
- Implement tiered service levels
- Enhance vendor and alliance management capabilities
- Improve purchasing power through buying consortia
- Implement automation tools for end-to-end IT process improvements
- Enhance program management capabilities
- Extend self service/employ portal capabilities
- Leverage emerging technologies to reduce expenses

Operational effectiveness

**Tactical**
- Identify focused, quick-win opportunities to accelerate revenue
- Cut poorly supported projects
- Fix systems with high operational failure rates
- Accelerate implementation of high-impact, cost-reduction projects

**Structural**
- Enhance business partner relationship management practices
- Reengineer business processes with improved use of IT
- Implement IT chargeback mechanisms to link charges for IT services to consumption
- Develop enterprise architecture to improve technology alignment with business model
- Sell or license value-generating assets, such as proprietary software and IT-enabled business capabilities

Capital efficiency

**Tactical**
- Sell technology assets and lease back as services
- Lease, rather than buy, new technology
- Increase use of existing technology:
  - Halt or defer work
  - Save on licensing or maintenance increase on added technology
- Cut or defer non-critical (major project) development:
  - Reduce contractors and in-house staff
  - Defer technology upgrades, support, licensing, and maintenance
- Accelerate plans to outsource or offshore:
  - Reduce contractors and in-house staff
  - Reduce demand for technology capacity

**Structural**
- Maximize application development productivity
- Develop sourcing strategies for capital intensive activities, such as technology infrastructure and data centers
- Build to optimum capacity; maximize use of available capacity
- Outsource peak volume requirements
- Establish a formal demand management process to optimize capital deployment decision-making
Balancing risk and savings

In the current economic climate, the pressure to cut costs is palpable. Yet making needed cuts while keeping an eye on encroaching risks is no easy task. Clearly, the stakes are high for an organization and its people. The wrong kind of cuts can potentially trigger reputational damage, customer and market valuation loss, and an increase in privacy issues and litigation. In fact, IT executives should be wary of the following risks:

1. **Financial Risk.** Risk associated with failure to deliver on proposed business case, or the risk of harm to operating financials.
2. **Operational Risk.** Risk associated with impairing the organization’s ability to deliver high quality products and services as a part of its day-to-day operations.
3. **Compliance Risk.** Risk of harming an organization’s ability to comply with legal or regulatory requirements.
4. **Strategic Risk.** Risk of impeding an organization’s ability to deliver on its strategic priorities.
5. **Reputational Risk.** Risk of damaging how key stakeholders view an organization and its commitments to others.

As an organization embarks on an IT cost cutting path, the following key objectives should remain top-of-mind for IT leaders:

- Take high-impact actions that will successfully deliver cost-cutting aligned with management’s priorities
- Strike a balance between rapid and more sustainable actions
- Avoid unforeseen financial consequences such as stranded costs, unanticipated tax implications
- Maintain critical organizational capabilities and performance
- Avoid increased systems outages and degraded performance
- Maintain agreed IT service delivery levels
- Continue to support critical strategic initiatives
- Deliver on the IT cost-cutting commitments

It will take an experienced team to help a company keep these objectives on track—a team that is issues-led and data-driven, and that learns from the lessons of others, investigates relevant costs components, builds strong business cases, and demonstrates commitment to effecting positive change. Such a team will be positioned to achieve strong results in the short-term, while making sure that the “babies of strategic value” have not been thrown out with the bath water.
Two client approaches to cutting IT spend

**Client situation #1:**

A major energy company invested in its mid–back office processes (finance, operations, procurement, inventory management) and systems to drive significant change, including process simplification and standardization, improved data quality, improved and automated compliance, improved financial management and cash management and significant improvement in procurement and materials management. The project was approaching $1bn in total spend and its senior executives were uncomfortable with the estimated cost.

**Assignment:** KPMG was asked to undertake a cost review of the company’s project to explore opportunities for cost reduction.

**Approach:** The KPMG team assessed the project using a number of external and internal reference points to identify areas of potential saving and/or underinvestment that would increase risk. The project team was composed of a number of experienced business transformation and major IT system delivery professionals, all of whom had significant program delivery experience that could be applied to the client situation.

The project plans and budgets were heavily scrutinized with each budget owner asked to provide an assessment versus examples of good practice. This identified a series of cost hypotheses through which the project team could explore savings.

**Results:** Over five weeks, the KPMG team identified potential cost savings of up to $130m through seven hypotheses, which were then refined and assessed by the client to identify those opportunities the client could actively pursue.

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**Client situation #2:**

A global communications holding company with a very large IT component was facing year-over-year budget pressures and required an approach to transform its overall cost structures in lieu of reacting tactically to the annual budget reduction.

**Assignment:** KPMG was asked to help the client develop an approach to re-architect and implement a streamlined IT service delivery model to proactively meet this annual challenge.

**Approach:** The KPMG team developed a service delivery transformation program for the client. Cornerstones of this program included:

- Defining key cost drivers and identifying short-term and long-term opportunities for cost reduction.
- Developing approaches to address asset underutilization and elimination of unnecessary software products and licenses.
- Simplifying the client’s complex sourcing environment by analyzing contracts, identifying cost improvement opportunities and consolidating providers.
- Implementing a new organizational structure and operating practices based upon proven IT frameworks such as ITIL, COBIT and ISO 20000.
- Applying IT automation capabilities to reduce the manual labor required to conduct day-to-day IT operating functions.
- Establishing key actions to realize costs savings and reduce consumption of energy within the data centers.

**Result:** The initiatives that KPMG completed with the client resulted in an improved approach for the delivery of IT services to the business and helped identify over $250M aggregate potential savings.
How KPMG can help

When it comes to achieving the right balance in IT cost-cutting, KPMG’s IT Advisory can help. As a vendor-neutral adviser, we help organizations through objective advice. Unlike hardware and software vendors, systems integrators, and IT service providers, this advice is impartial and geared to the specific needs of our client. Working hand in hand with members of senior management, we help them as they look to make the right choices at the right time—and at the right cost.

What’s more, we possess the capabilities to help you deliver on your IT cost-cutting commitments, including:

- Experienced and trustworthy advisors capable of helping organizations align IT with business objectives
- Vendor neutrality and professional skepticism
- Knowledgeable IT, tax and accounting professionals that can help provide the analytic rigor and fact-based business cases to meet the requirements of the CFO
- Balanced approach to addressing growth and risk
- Deep financial, regulatory, IT control, and industry knowledge
- Experience serving market-leading clients of all sizes, including nearly 75 percent of Fortune 1000 companies
- A full range of service offerings

KPMG’s IT Advisory services can help your organization manage costs, improve the speed and quality of service, and increase the alignment between IT and the business.

Support you can depend on

KPMG’s IT Advisory team is a trusted advisor to the boards of some of the world’s largest multinational organizations. This global reach through KPMG’s member firms extends to the developed markets as well as to the high growth economies of Central and Eastern Europe, Central and South America, and Asia-Pacific. Standing strong with more than 6,000 team members, we can help you reach your business goals in an intelligent and timely manner.
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