

German Perspective: Five Ways to Improve Investment Confidence and Return on IT Assets

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Traditional "fit and forget" approaches to IT asset investments or vendor contracts are inadequate. Build IT investment confidence by better measuring and optimizing spending against business objectives throughout asset and contract life cycles.

Key Findings

- IT investment confidence depends on more than initial projects success. After a project enters production, it requires ongoing management, reporting and optimization.
- New projects and IT asset acquisitions result in long-term vendor relationships and ongoing cost commitments that continue throughout contract and asset life cycles.
- Pressure to obtain funding or to achieve short-term savings tends to increase IT costs overall — in other cost categories and in other budgetary periods — damaging business confidence in the IT organization.
- Organizations that systematically align IT costs with business objectives can significantly improve their access to funding and the success of asset investments.

Recommendations

- Involve IT procurement and asset management specialists in ensuring that initial project cost projections and business cases are realistic and accurate.
- Hand over business cases and metrics to production, to be maintained and measured with key cost indicators and key risk indicators, not only key performance indicators (KPIs).
- Maintain and update the business case for each project, working with stakeholders and budget holders to optimize your asset positions in response to changing business conditions and objectives.
- Report across all IT assets and their costs, not just new project investments. Key indicators are most effective when they enable managers to match asset costs with related performance metrics.

ANALYSIS

The German and European flair for precision in planning and engineering is often seen as a virtue in many business disciplines (see Note 1). This drive for perfection is inadequate when it comes to decision support for IT investments. An exact business case or detailed return on investment (ROI) calculation can require significant effort, with little or no return on the effort invested. This can affect a large number of German organizations because, according to the last Dataquest Gartner 2007 end-user survey, 52% of those organizations are rationalizing their cost-cutting objectives with their investment requirements.

An inability to translate business targets into technical IT asset metrics can leave IT professionals hunting for intangible benefits "in the fog." Theoretical ROI calculations may contain variables to which only experts can relate. The value contribution of the IT organization has been compiled and rated positive (see ["ITK-Branche erzielt Rekord bei der Wertschöpfung in Deutschland"](#)). However, an inability to handle detailed internal business cases can result in superficial reasoning in favor of whatever the project owners feel is worthwhile. Although the trade press regularly tries to provide scientific approaches to the best-of-breed evaluation (see ["Der Wert der IT für das Unternehmen ist quantifizierbar"](#)), this research shows a way out of such overengineered calculations, shifting the emphasis to more-active, real-world value management after project implementation that checks any theoretical assumptions made in the business case.

An asset is an economic benefit, controlled as the result of a past transaction. Few asset management programs manage these economic benefits. IT costs start with an asset acquisition; they do not end with it. Failure to control the costs and benefits of spending is poor business management. Enterprise confidence in new IT investments depends on the CIO's ability to demonstrate effective results in return for that investment. Alignment with business objectives can be achieved only by measuring costs against results.

Five Measurement Principles

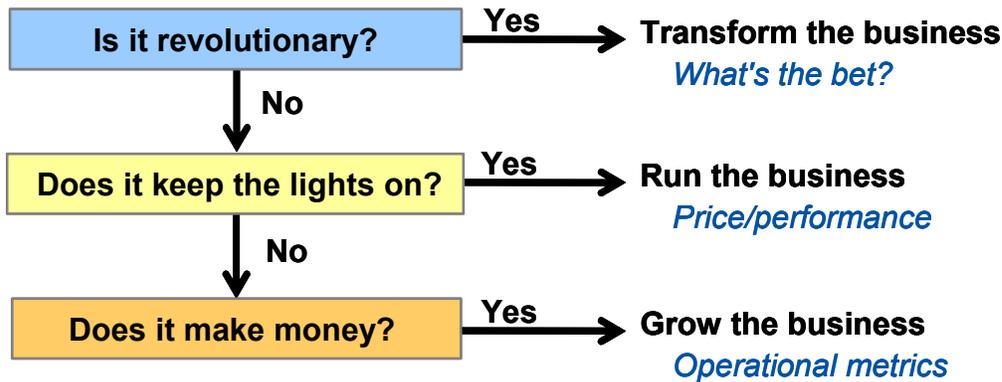
To manage costs against objectives requires figures that are countable, complete, current, competitive and compelling.

- *Countable* is an assumption — we assume that costs are counted. Most organizations count their spending but not their costs. This takes careful preparation and planning. Your operating budget or cost models may not reflect what each asset really costs.
- *Complete* is the most important principle to underwrite business confidence by avoiding unbudgeted costs. Gartner's total cost of ownership (TCO) methodology provides a comprehensive way of capturing total life cycle costs.
- *Current* data is needed — time stamp data that is not updated in real time. Current refers to work with stakeholders and budget holders to update the business cases and objectives against which asset investments are measured.
- *Competitive* is a key principle because the IT organization often competes for limited funding and operating budgets. Competitiveness is also an important business objective, even in the public sector where organizations are accountable for spending public money.
- *Compelling* means that your numbers and metrics need to make their point clearly and without ambiguity. Assumptions, margins of error and risks also need to be accounted

for in measurable and verifiable ways, with key cost indicators and key risk indicators, as well as KPIs.

These measurement principles are applied to five business case scenarios, within the context of the Gartner priority framework (see Figure 1).

Figure 1. The Grow, Run, Transform Value Framework



Source: Gartner (September 2008)

Grow the Business

Directly or indirectly, spending should continue to enhance the organization throughout the asset life cycle.

Case 1. Revenue Generation

Revenue seems the simplest way to measure return on assets. Most business revenue depends on more than IT assets, but a completely automated, Web-based sales and delivery cycle is a good IT-only example, which shows how technology can unlock additional revenue streams. The conditions under which the business case was formulated can change. The business case requires regular review to ensure that revenue exceeds costs as planned. A specific key revenue indicator metric is required.

If revenue falls or costs rise, then the root cause cannot be determined unless costs are tracked against returns. The alternative is that businesspeople tend to cut all new IT spending, even if the cost of operating, maintaining and updating aging IT assets will rise as a result. Cuts to a Web-based sales and delivery cycle can also damage the customer experience and cut revenue further. Businesspeople then try to develop new revenue streams to make up the shortfall, creating more poorly identified IT costs.

Profitability can be restored only by repurposing or reallocating IT assets to maximize revenue. It can be painstaking forensic work for consultants to identify causes for the loss and recover the situation. Few enterprises act decisively before the situation becomes unrecoverable and the line of business is divested. As a result, IT investments are seen as speculative and fraught with risk. Attitudes to IT investments are unlikely to change unless IT accounting practices change these attitudes.

Case 2. Value Proposition

A value proposition is different because value may not be captured as revenue. For example, a conventional line of business may be struggling to compete in a highly competitive marketplace. It will need to reduce costs or deliver greater value to recover market share and restore profitability. Free membership of an online service is an increasingly popular added value ascribed to traditional products and services. Compelling figures can demonstrate viability, even if the online service is not initially profitable. A key value indicator, such as the number of accounts, can help.

A magazine publisher might run several loss-leading Web sites simply to achieve more Web presence and earn more advertising revenue for its profitable titles. If there is a spike in Web traffic, then the publisher will have enough capacity to prioritize its most-profitable Web sites. The magazines that benefit most from this arrangement, therefore, should pay more or they will risk losing the loss leaders and pay more anyway. It is a simple question of revenue alignment. A key value indicator metric can help indicate who earns the greatest value from this arrangement.

It may be uneconomical to license enterprise software for occasional users. However, if these additional users help the organization negotiate a better software deal, then they can be charged back at a discounted rate. The full-time users pay what licenses would have cost as an accurate representation of market price, even if the vendor does not offer two pricing schemes, one being for "light users." Market value is context-sensitive but quantifiable; it simply needs to be accounted for.

Run the Business

IT services must continually demonstrate improvements in price/performance while keeping the lights on and IT systems running.

Case 3. Cost Reduction

Many organizations embark on cost savings exercises without first counting their costs. They identify external payment streams but cannot capture cost details and interdependencies. Chasing savings on servers can result in higher software costs and higher total costs. Server teams that consolidate servers or deploy hypervisors can cause software licensing costs to increase if they are unaware of the cost implications (see "Plan for Software Licenses to Keep Virtualization Costs Real").

Completeness is the basis for Gartner's TCO methodology. It ensures that all costs, include life cycle costs, are managed. Savings made in one budgetary period can increase costs in the next. It is equally important to maintain an overview of all costs throughout at least one asset or contract life cycle. Postponing asset reinvestment simply pushes costs into the next budgetary year, creating a false sense of financial security. If lines of business stop paying depreciation, then they lose the habit of reinvesting in IT and start to see it as optional (see "IT Modernization: Modernize IT Funding to Modernize IT and Legacy Data Storage"). Key cost indicator metrics are essential.

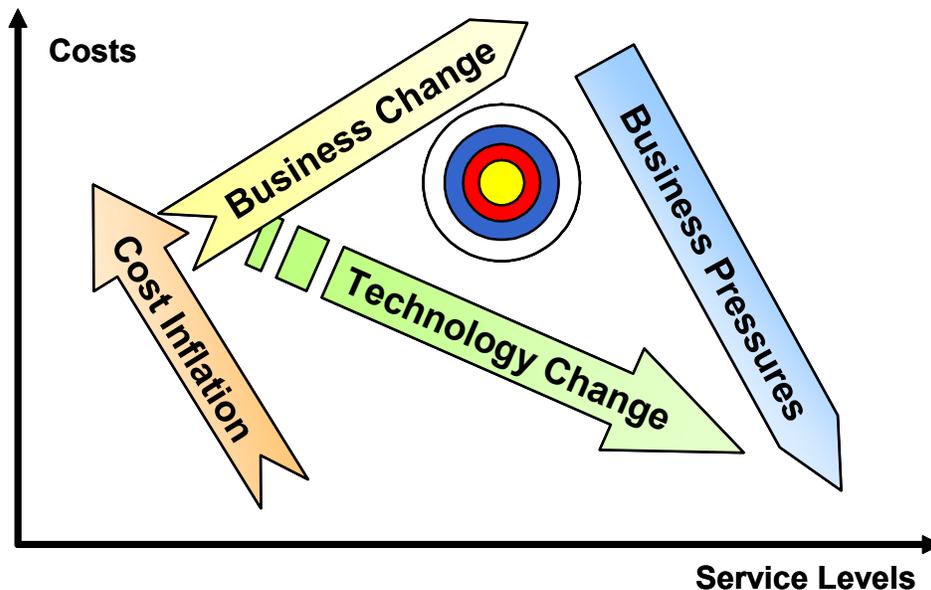
An enterprise cannot apply the 80/20 rule and account for only 80% of its invoices. Only the enterprise finance department has the oversight and experience needed to determine which revenue or costs are material to the corporate accounts. To conduct an ABC or Pareto analysis, you must first account for and classify all costs. There are often hidden costs. We often find that customers underestimate approximated costs by up to 80%. Few organizations can calculate TCO to more than 80% accuracy unaided.

Fewer IT projects include realistic ongoing licensing and maintenance cost projections. Both costs can rise after the vendor has won the business, and initial discounts and contract periods

end. Initial project savings and discounts are rarely sustainable. When bundled free-of-charge with a purchase, the price of maintenance often missing from annual operating budgets. An aid to planning is provided in the "Toolkit Sample Template: Manage the Software Investment Life Cycle." Maintain a complete central view of IT costs to ensure that savings in any one area do not raise costs in another.

Cost savings can also be a zero-sum game, where you can never win. Zero costs rarely stand still long enough for you to measure them (see Figure 2).

Figure 2. Changing Conditions Can Make It Almost Impossible to Hit Savings Targets



Source: Gartner (September 2008)

Case 4. Risk Reduction

Risk management often is seen as the key to business success, but risk acceptance decisions cannot be based entirely on cost. Risks have legal and regulatory implications if they impact investors or customers. Many legal systems have the notion of a duty of care, where company officers are held responsible for their conduct. Executives make a valid point when joking that ROI now stands for "risk of incarceration" rather than ROI.

Risk management involves keeping risks off the balance sheet. It is an important sourcing activity to assess supply chain risks and to build protection into contracts. Different organizations also have different risk appetites. Some prefer to spend more with leading vendors to reduce some risks, while others prefer smaller vendors over whom they have greater financial control. Unbudgeted cost increases are another risk that IT organizations must manage. Negotiating better contractual terms with vendors can make costs more predictable. Key risk indicators should combine commercial and operating risks.

Competitiveness is one of the most-difficult attributes to demonstrate, because it can require an exhaustive search of all options. The sourcing and procurement process must demonstrate that it reflects business concerns and objectives. Maintaining competitiveness takes more than getting the most-competitive initial price. After a major purchase, the customer may have little leverage. As enterprises enter an age of accelerating competition for resources, their ability to manage

commercial risks by managing vendors, assets and contract life cycles becomes increasingly important.

Transform the Business

Frontier spending may have an uncertain outcome, but it can be vital to explore new business opportunities when established markets become less profitable.

Case 5. Speculative Investment

Businesspeople are reluctant to commit to fixed IT costs when the outcome is uncertain. They often understand that IT costs are difficult to fix. Business units, therefore, want more-flexible options, even if they have to pay a little more for that flexibility. Capacity-on-demand or soft orders can make a significant difference to the business cost of IT, helping to align costs with business revenue. Externally provided IT services can also help, but only when contracts are truly flexible. Other agility options include buying generic assets that can be repurposed if the current business initiative fails. To know when your Web commerce site is in trouble so you can find a new channel for the hosting contract, you have to measure earnings against actual costs and risks. It is not enough to use a theoretical cost model if the hosting site increases its fees. KPIs are needed to manage revenue against risk and cost.

Without alignment between IT spending and business objectives, all IT investments can be seen as speculative. Most enterprises will only invest what they can afford to lose. IT finance teams tend to manage spending, not costs. They track how much their enterprises pay vendors, but not how much it costs to operate the Web server. IT asset management (ITAM) is the critical discipline that is missing.

ITAM is the clearing house for essential IT management details. ITAM requires significantly more than scanning the network to see how many computers are connected to it. It is about compiling IT business metrics that make the difference between a speculative investment and managed, strategic investment decisions.

IT organizations are improving their business management to earn the respect and investment of their business users and senior management. Initiatives often start with one project or one type of asset, but success makes them more sustained and comprehensive. A mature ITAM program unites business budget holders with the IT organization and its vendors to achieve mutual commercial benefit.

RECOMMENDED READING

"Five Ways to Improve Investment Confidence and Return on IT Assets"

"A Maverick Approach to the Business Value of IT"

"Best Practices for Maximizing Return on IT Asset Investment"

["ITK-Branche erzielt Rekord bei der Wertschöpfung in Deutschland"](#)

Note 1 The German Perspective

The German Perspective was provided by Peter Wesche.

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