How to Defend IT Budgets Against Damaging Spending Cuts

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CIOs are sometimes instructed by their boards to make business-damaging cuts to IT budgets without accounting for the business impact on the IT services. This research highlights the protective strategies CIOs should adapt to minimize collateral business damage and protect IT's reputation.

Overview

Key Findings

- Not linking IT spending to business activity affects the business stakeholders' ability to protect their stakes in ongoing IT spending decisions and understand the business impact of spending cuts.
- Only 35% of organizations have a consistent cost management framework. As a result, spending cuts to centrally funded technology often increase business costs or result in business technology spending that might not be sourced or run as cost-efficiently without corporate economies of scale.
- Business decision makers rarely stop spending cuts because they are largely unaware of the potentially damaging and dangerous impacts on business performance that can make a bad situation worse.

Recommendations

CIOs focused on minimizing the collateral business damage and protecting their investment should:

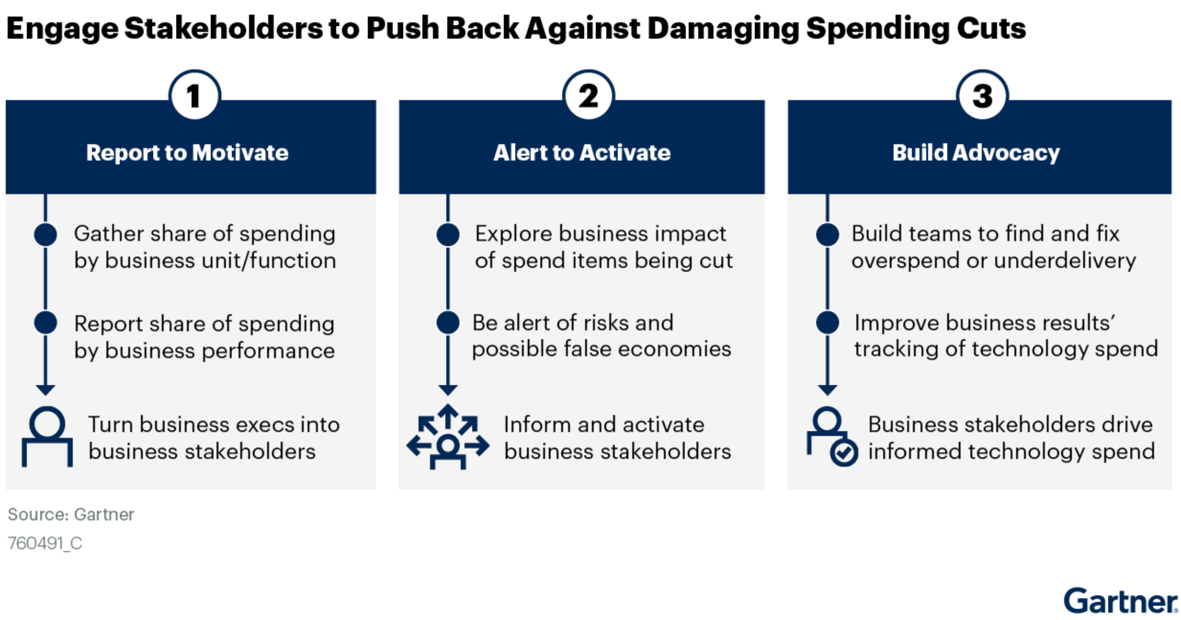
- Motivate business stakeholders to champion the technologies on which their business depends by reporting technology spending for each business line against its performance data.

- Alert business units to prevent technology spending cuts that create false economies by identifying whether the spending cuts risk damaging business performance or costing the business more.
- Develop advocacy by keeping business executives engaged in improving technology spending decisions to consistently drive positive business outcomes.

Introduction

CIOs cannot continually cut spending without negative business consequences. A failure to articulate the connection between technology spending and business outcomes is often the root cause of pressure to cut IT budgets. Organizations without mature IT financial management are less likely to communicate their business value. Figure 1 lists the three steps for CIOs to engage stakeholders to push back against damaging spending cuts.

Figure 1: Three Steps for CIOs to Engage Stakeholders to Push Back Against Damaging Spending Cuts



When pressed to cut costs reactively, CIOs often respond opportunistically by starting with what's easiest to cut within IT. Opportunistic cost cutters often view technology refreshes and upcoming contract renewals as easy targets; projects creating much-needed value may also be seen as discretionary spending. There's often a reluctance to consult stakeholders about business risks in case they get in the way of meeting cost reduction targets. To counter the threat of cost cutting, project management offices (PMOs) encourage business stakeholders to protect new investments by linking new technology investments with business strategies and critical priorities. CIOs can take a similar approach to protect other areas of technology spending.

The risks of poor financial decision making increase in organizations under financial stress. Risks increase further when corporate teamwork breaks down into competing self-interests. CIOs can use this research to:

- Start reconnecting technology spending to business performance.
- Build more productive relationships that involve business executives as stakeholders, sponsors and advocates for better informed technology decisions.

Analysis

Motivate Business Executives by Reporting Technology Spending Against Performance Data

Gartner IT Key Metrics Data provides essential high-level industry context that CIOs can use to:

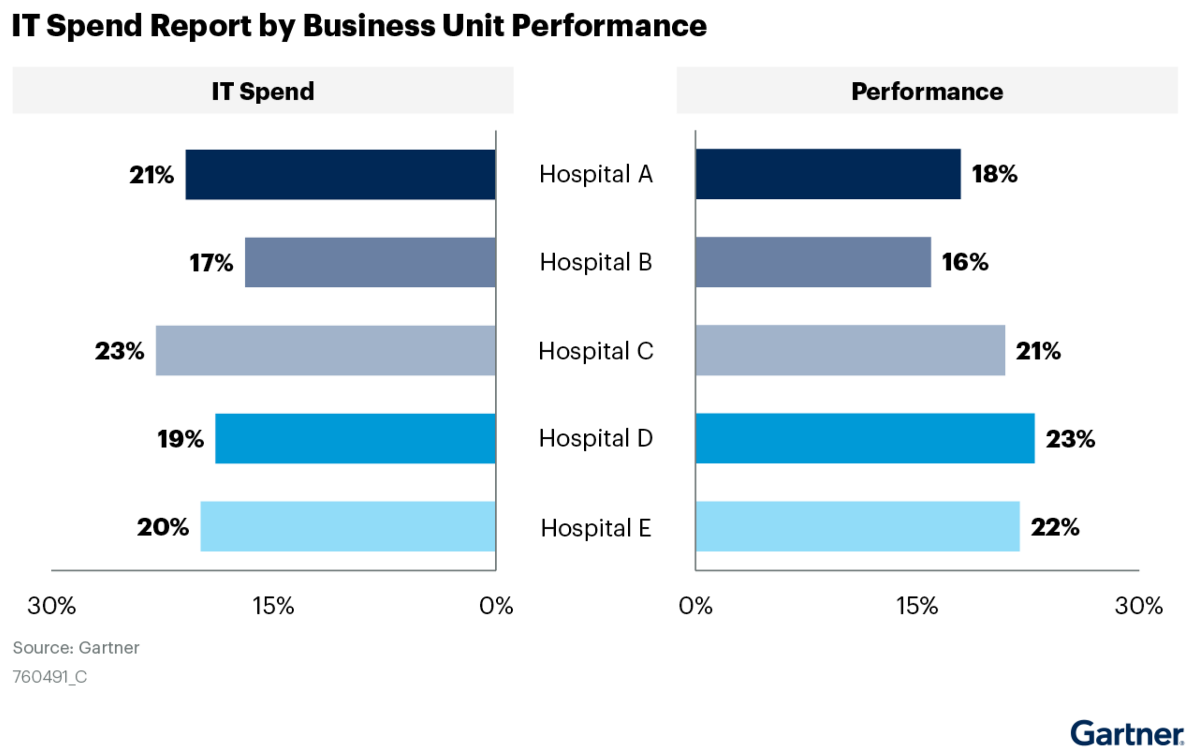
- Plot the organization's position using Gartner's IT Budget & Efficiency Benchmark. This will help to create informative and comparative views of the organization against those of its peers.
- Explore the relationship between IT spending and the corporate performance of industry peers with the Gartner Cost Value Matrix. This framework looks at how the IT organization is positioned relative to company revenue and margin.

When IT spending benchmarks are below average, further cuts are unlikely to improve important business value KPIs such as employee productivity or profitability. However, the data from Strategic Cost Optimization Score for IT reveals that organizations aren't mature enough to demonstrate the business value of IT spending, which they rank as the most important priority for strategic cost optimization. [1]

One of the most powerful things a CIO can do is to present a business view of IT spending. Creating a business view empowers business executives to see the relationship between the two. CIO's drive to improve business results is the best protection against technology spending cuts (for example, CRM spending is less likely to be cut when driving sales growth).

The "rosette" example in Figure 2 highlights each business unit's share of IT spending against its performance. It shows senior executives how IT spending aligns with business performance. In this nonprofit healthcare example, nonfinancial metrics are based on quality of life years (QALYs). [2] Hospitals A, B and C have more IT spending compared with their business performance, which requires further investigation. Generally, higher technology spending is often the result of a corporate strategy to increase business performance. When spending cuts put strategic performance gains at risk, stakeholders need to defend them.

Figure 2: IT Spend Report by Business Unit Performance



The illustrative chart highlights the IT spending for each business unit against its performance. The inner ring of the "rosette" shows the percent performance contribution of five hospitals and the outer ring comprises the percentage of IT budget sp

Creating this view isn't as hard as many think. IT spending is typically managed by asset category and budgeted by technology service domain. Realign this data by reporting the proportion of each technology budget spent on behalf of each business unit. IT staff typically forecast, budget for and track the business unit needs they serve. When asked, they can normally estimate proportional shares of spending even where monitoring tools cannot. Avoid unnecessary detail unless cost allocation already supports effective showback or chargeback (chargeback is covered later in this research). Business executives first need to investigate the value of IT spending on their business unit and then check whether it is safe to cut spending.

IT systems manage a wealth of corporate information, including business performance data. Pick metrics the audience cares most about and link IT spend to these metrics to drive business engagement. Use this performance information to challenge misperceptions about IT spending and business outcomes among business executives, boards, investors and funding bodies.

CIOs can follow the above simple steps to:

- Make technology spending a business decision by reporting it by business unit or function.
- Establish the relationship between technology spending and business performance through reporting.
- Turn business executives into technology stakeholders by showing what's at stake if IT spending is reduced.
- Motivate business executives to see technology as an investment to protect, not a cost to cut.

Alert Business Units to Prevent Spending Cuts That Create False Economies by Continuing to Report and Investigate Spending Against Business Performance

Successful organizations use capability models, value streams or outcome metrics to manage the business value of technology spending. But there isn't time to adopt these best practices to push back against damaging spending cuts. Many metrics still focus on new technology investments, overlooking their ongoing business operation. This can perpetuate the dangerous illusion that technology operating expenditure can be cut without consequences.

Before making IT spending cuts, conduct a risk assessment with the business stakeholders. Otherwise IT budget cuts risk damaging customer value or business resilience to become the root cause of business underperformance. CIOs must alert executives to protect their enterprise from shortsighted and excessive cuts that result in false economies and further business underperformance. A false economy is a saving that ends up costing the enterprise more.

Example of a False Economy: A CIO cut IT operating cost by 0.2% of revenue on the advice of a business consultancy, resulting in manufacturing delays costing over 2% of revenue. Here, the CIO failed to highlight the risk of cutting maintenance and support to match IT spending with less digital competitors.

It is wrong to think that technology costs simply go away when items are removed from IT budget plans. Reduced spending can often result in technology debts going unserviced and continuing to accumulate, as described in Manage Technology Debt to Create Technology Wealth. CIOs should instruct their teams to keep a separate note of technology costs that are moved out of the IT budget. Cutting IT spending only shifts the problem because business needs don’t go away. Cuts often drive technology spending out into the business units, where it risks being sourced and run less efficiently. Eighty-four percent of executives now recognize the importance of managing enterprisewide technology spending against business value, but only 32% believe they demonstrate it well. [3]

Business unit withdrawal from a shared service rarely results in immediate IT spend reduction because IT has already committed to the cost to serve them. The business unit buying its own IT services independently then adds additional cost to the enterprise. The blurring of business and technology roles makes the total amount of time, effort and money spent on technology less visible across the enterprise. [4] It is an illusion that technology spending has been reduced when it has only been moved out of the IT budget.

To correct this illusion, CIOs should:

- Ask stakeholders to identify the IT services they believe cost more than they are worth.
- Check the business impact of cutting or withdrawing IT services to validate requirements.

- Explore sourcing and efficiency improvements to check for overlooked cost reduction opportunities.
- Balance the risks of service reduction or removal with the cost of risk mitigation to enable stakeholders to make informed decisions.
- Obtain business agreement to transfer funds into IT in place of moving IT costs out to business units where they cannot be as effectively managed or optimized.

Develop Advocacy by Keeping Business Executives Engaged in Improving Technology Spending Decisions to Consistently Drive Positive Business Outcomes

CIOs should always consult and inform stakeholders, instead of making business decisions and accepting risks on their behalf. This makes business stakeholders more effective advocates for technology spending at board level. Even when formal IT budgets are limited to back-office infrastructure and foundational digital workplace services, they continue to be impacted by technology spending decisions made by business units. [5] The need for close collaboration continues regardless of technology executive role or job title.

Business units and subsidiaries sometimes challenge technology spending and call for budget reduction because of the way they are being charged for IT. Common issues include arbitrary charges against business revenue and overcomplicated cost models that don't match actual spending or include the cost of other shared services' IT systems. CIOs should review the charges received by business units against what they spend on their behalf. Actively listen to business stakeholders and work to resolve technology cost objections as the stakeholders may only be objecting to accounting practices, not actual spending. CIOs should also expose the root causes to resolve the differences between chargebacks and spending on behalf of business units.

Example of business pushback:

An EMEA food and beverages CFO made a major ERP investment to drive business value. Business executives pushed back on the cost, challenging the CIO to justify the value of investments made by the CFO to drive them to deliver more business value.

CIOs need to build a consultative team of technology, business and financial experts to target areas where spending is considered disproportionally high or inefficient. A detailed forensic and impartial investigation overcomes misperceptions, eliminates wasteful inefficiency and applies technology more effectively to increase business value (see Case Study: Cost Optimization Consulting for Democratized Technology Delivery). CIOs can highlight these results in standard technology spending reports to show business advocacy.

In emergency cost-cutting situations, CIOs rarely have enough time to fully consult and engage business leaders. Limited time and resources may only permit intranet, direct messaging and email communication channels for cost reductions. But uninformed executives often waste more time challenging decisions they don't understand and uninformed challenges fail. This is why CIOs should provide business executives and their direct reports with the information they need to appeal to the CFO and the board against damaging cuts. Also, technology executives must work even harder to inform decision makers during a crisis, when this information is more critical than ever.

To sum up, CIOs should:

- Gain the support of business executives by consulting them to check that technology spending decisions make sense to their business.
- Notify and inform business executives about counterproductive technology budget cuts so they can push back against them more eloquently and effectively.
- Build teamwork to troubleshoot, find and fix the technology issues behind business inefficiency and underperformance.
- Work with executives to meet their business performance targets and make IT spending cuts unnecessary in the longer term.

Conclusion

Business executives see the business value of technology spending when IT follows a value-optimized operating model, as described in How to Structure I&T Into an Interconnected, Value-Optimized Organization. Under a less mature asset, process or service optimizing model, the most successful pushbacks occur when CIOs have nothing left but budget cutting proposals that will be painful, disruptive and unacceptable to business executives. Senior executives must either accept the business impacts of these reductions, propose viable alternatives or identify additional sources of funding. Technology enables business cost cutting far more effectively than the business enables IT cost cutting.

Evidence

[1] Data from Strategic Cost Optimization Score for IT shows that aligning IT spend to business value emerged as the highest important activity (3.8/5) from March 2021 to March 2022 (n = 107).

[2] Quality-Adjusted Life Years — What Is a QALY and Why Should We Care?, MAP.

[3] The 2022 Gartner 2022 Enterprisewide Technology Spending Survey found that 84% of business, finance and IT leaders consider it important or extremely important to manage the business value of all enterprisewide technology spend. While only 32% consider themselves effective or very effective at demonstrating the value (n = 140).

[4] As per Rethinking IT-Business Engagement, on average, 41% of employees outside of IT customize or build data or technology solutions.

[5] Forty-nine percent of digital business initiatives are funded directly by business units (see Figure 18 in Digital Business Requires a New Normal in IT Finance).

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