

How IT Investments Today Will Be Rewarded Tomorrow

By Deborah Asbrand

Managing amid an economic slowdown is an inescapable fact of corporate life. For executives in all industries, it is as much a constant today as strategizing for growth and market-share gains tomorrow. But this recession brings with it a new and important wrinkle: IT, once considered a discretionary expense, is now the heartbeat of business.

The challenge of how best to invest in IT during a downturn is coming into sharp relief as leaders grapple with the dual tasks of managing IT costs while still spending to maintain efficiency and prepare for the return of market stability. That is, they are honing an IT function that is strategic, innovative, and thrifty.

Investing Strategically in IT

To keep up with the transactions that are the pulse of any company, some amount of IT spending is fixed and always necessary. What is interesting, however, is that despite the economic recession and widespread budget cutting, many experts today predict the ongoing need for small IT budget increases.

Forrester Research’s revised IT spending forecast for 2009 projects growth of 1.6 percent. That is down from the comparatively robust increase of 4.1 percent in 2008. But the forecast shows growth nonetheless, and it indicates an assumption that many companies will in fact continue to invest strategically.

For companies spared the worst, downturns can be important opportunities to strengthen and reorganize. In a study of how 1,000 mostly U.S. companies weathered the 1990-1991 global recession, consulting firm McKinsey & Company found that those firms emerging as winners had refocused their spending, not just cut it. But the most dramatic response to the recession that McKinsey noted from the leaders—and the least expected—was their approach to operating expenses.

While most companies tightened their belts, successful leaders—trading lower short-term profitability for long-term gain—reprioritized rather than cut spending (see chart, “A Contrarian Approach to Operating Expenses”). Indeed, these leaders, perhaps reasoning that a soft market required greater effort or provided greater opportunity, actually spent significantly more on selling, general, and administrative (SG&A) costs (including IT) than did companies that lost their market leadership.

Indeed, new research shows that organizations that want to continue climbing the productivity curve understand the importance of IT. Technology-intensive companies

New research shows that companies that want to continue climbing the productivity curve understand the importance of IT.

Chart 1

A Contrarian Approach to Operating Expenses

Gap between successful leaders¹ and less successful former peers.
 (Change in spending behavior, percent)

	SG&A ²	R&D ²	Advertising ²
1990-91 recession	14.0	22.1	9.2
Expansion ³	-14.2	8.8	-3.4

¹Successful leaders remained in top quartile of their industries as reckoned by market value added and return on invested capital during the period 1982-99.
²Selling, general, and administrative (SG&A) expenses are measured by index of SG&A spending to sales, R&D expenses by index of R&D expenses by index of R&D spending to sales, and advertising expenses by index of advertising spending to sales; all are measured on size-adjusted basis and compared with industry averages.
³1985-86 and 1995-96.

Source: McKinsey & Company, *The McKinsey Quarterly*

Research Update—Rethinking IT Investment Strategies in a Recession

tend to be more productive and competitive, according to extensive studies by MIT Professor Erik Brynjolfsson. In fact, Brynjolfsson says investment in technology correlates directly with the rise in corporate productivity over the last decade.

Yet reaping the productivity payoff often depends on events outside of the IT function. The most effective users of information technology also make complementary organizational investments in people and departments using the information, Brynjolfsson found. They plow capital into standardizing hardware and software, with an eye toward making information easier for employees to access.

The most productive companies also carefully measure their operating efficiencies and use these metrics to gain a clear view of strengths and bottlenecks. Recruiting the right people is another priority for these market leaders. The result is that among companies that use technology wisely, more people are working, fewer are managing without purpose, and productivity is higher.

What is more, in a review of enterprise systems purchases and decisions among 2,400 U.S. companies from 1998 to 2005, Brynjolfsson’s research spotted a logical domino effect: Initial investments in IT drove performance gains that encouraged further investments over the course of several years.

Refocus, Not Retrench

When economies sour, though, the productivity scenario can change quickly and dramatically. Workforces shrink; competition intensifies; capital investments decline. All corporate spending comes up for review.

“Even companies that are doing relatively okay will slash their spending because they use the opportunity to get rid of dead wood and make other cuts,” says technology veteran and Villanova University Professor Steve Andriole. “Companies do their serious yeoman’s work during crisis. When things get bad, that is when they make tough decisions.”

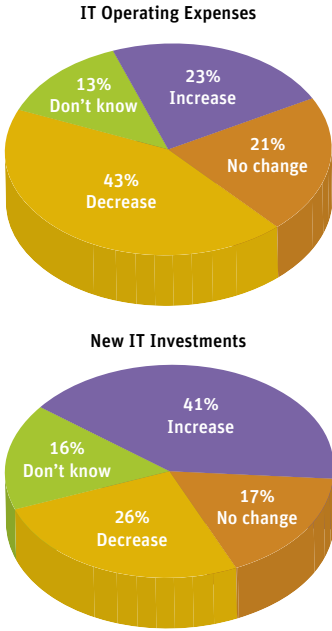
Making the right IT decisions in a downturn can make a huge difference once recovery is underway. A review of the 1990-1991 recession by management consulting firm Accenture identified investments in information systems as a hallmark of high-performing companies. According to Accenture, recession-timed purchases in computer-based modeling, for example, gave companies the ability to manage and gain insight about their key value drivers. More importantly, the companies put the output to use. Poorly performing companies lacked similarly responsive systems, Accenture found.

UPS, for example, continued to plow dollars into technology through both the early 1990s recession and the dot-com implosion in 2000. The Atlanta-based delivery company digitized and integrated processes and added new services that allowed business clients deep visibility into its supply chain, says Rajiv Kohli, an associate professor at College of William and Mary, who has been a research partner with UPS.

Chart 2

The Outlook for New IT Investment

Economic belt-tightening in past eras often meant cuts for IT. A recent survey by McKinsey & Company signals that executives this time around may look to refocus, not cut, IT budgets (*Q. How if at all do you expect your organization’s IT budget for operating expenses and new investments will change in 2009? n=548*)



Source: McKinsey & Company global survey, “IT’s Unmet Potential,” 2008

Research Update—Rethinking IT Investment Strategies in a Recession

UPS's constant investment in technology is a defining characteristic of the USD \$50-billion company today and gives it a significant competitive advantage. Says Kohli: "UPS is an IT company that happens to deliver packages."

The Outlook for IT

Despite what we can learn from past recessions, the outlook for IT amid the current stark economic climate is uniquely different. For one thing, the wave of consolidations in the computer industry over the last few years means that those firms selling systems to midsize and larger enterprises are likely to be large, well-capitalized corporations themselves. Their sheer size, UPS's Kohli says, provides a measure of comfort to corporations understandably nervous about parting with precious capital during lean times.

"Companies are much more comfortable knowing that standing behind products are big companies that will be around for a while," says Kohli, co-author of *The IT Payoff: Measuring the Business Value of Information Technology Investments*. Another difference, he says, is that in today's global economy, "technology is pervasive and intertwined with business processes that companies just cannot function without. If you cut IT spending, the business will shut down."

Indeed, executive responses to a recent poll by McKinsey & Company may signal that companies are working to avoid the knee-jerk retrenching of past downturns. McKinsey took the pulse of 548 global executives in October 2008, surveying them on their companies' spending plans as the global economy progressed from bad to worse. Some of the results are expected. For example, only 23 percent of executives expect to increase their operating costs in 2009 while 43 percent expect to reduce them (see chart, "The Outlook for New IT Investment").

But the forecast for new technology investments is more nuanced. According to McKinsey, more than four out of 10 respondents revealed plans to boost their new IT investments in 2009. In addition to those spenders, another 17 percent say they will hold steady on IT spending. McKinsey concludes that these results suggest companies are prioritizing IT investments even as they cut operating expenses—a change from past downturns, when drastic cuts in discretionary IT investment were common.

Strategies for Success

Which IT investment strategies will work in the current economic climate? New technologies that bring productivity improvements and are priced attractively can offer companies genuine competitive and operating gains. Villanova Professor Andriole predicts companies will continue to invest in new money-saving technologies like voice over IP (VoIP), unified communications, and virtualization. He also expects to observe an acceleration in on-demand cloud computing, the latest way of storing information 'in the cloud' on the Internet.

"People do not have the money or the time for four-to-five year projects," Andriole says (see box, "Tips for Strengthening Your IT Portfolio in a Recession"). "The capital outlay for some projects that

"Initial investments in IT drove performance gains that encouraged further investments over the course of several years."

– ERIK BRYNJOLFSSON
MIT

Tips for Strengthening Your IT Portfolio In a Recession

- Avoid unnecessary replacements, interruptions, and user disruptions.
- Put projects with a payback of six months or more on the back burner.
- For critical projects that need longer to return their money:
 - Look at on-demand options to reduce initial and ongoing costs.
 - Break the project into phases by identifying which areas will have the greatest benefit first.
 - Negotiate with vendors based on those phases to reduce initial investments.

Source: Nucleus Research, "Managing IT in an Economic Downturn," October 2008

Research Update—Rethinking IT Investment Strategies in a Recession

you buy and install yourself is tremendous. But if you rent it, it becomes an annual variable expense. The pricing model for software as a service, or SaaS, is very consistent with the cost-cutting environment because you only spend what you use.”

In addition, the continued and rapid decrease in the cost of IT means projects that may have been too expensive only a few years ago may now be economically viable, points out consulting firm Diamond Technology. For example, Southern Company in early 2008 announced plans to automate its meter-reading system. Despite the deepening recession, the Atlanta-based electric utility company says it has no plans to delay its five-year implementation schedule. It hopes the project will provide accurate data on customer usage patterns and eventually lead to a bottom-line-boosting practice of dynamic pricing.

Customers Come First

Customers remain a top priority even (and perhaps especially) in cost-conscious times. As corporate coffers stay lean, the companies that fare best will be those that treat their customers well, cautions Nucleus Research. The IT advisory firm suggests that companies can reduce costs (and improve customer service at the same time) by continuing to streamline customer contact through multi-channel service and support, Web self-service, and greater customer community interaction.

In addition, business intelligence and unified communications technologies will help organizations keep customers close by—and help them home in rapidly on changes in customer or market behavior.

Companies will also do well by working to constantly freshen their market data—and their point of view. Improved analysis of structured data, the kind most often found in corporate databases, helps discover shifting customer behavior. It can detect swings in capital and labor markets and moves in commodity pricing, in addition to revealing the state of internal operations.

But structured data accounts for only part of the corporate information stream, advises Daniel Rasmus, director of business insights at Microsoft Business Division and author of the new book *Listening to the Future: Why It's Everybody's Business* (Wiley, 2008). The snappy, informal data derived from blogs, e-mails, wikis, and other personal and collaborative sources can also provide valuable insight into market drivers and customer behaviors or perceptions. But many companies have yet to master analysis of these unstructured data types.

Gain New Customer Insight

During the current downturn, though, the one-two punch of both structured and unstructured enterprise data sources will likely be needed by market leaders. Fortunately, leveraging the two is getting easier as information is combined and dispersed through easy-to-use business intelligence applications.

“In turbulent economic times, opinion, emotion, and feedback loops reinforce or exacerbate decisions based on real data,” Rasmus says. “Keeping track of what people are thinking, what they are seeing, and what they are feeling is important in times of uncertainty. The combination of data sources can bring real insight to an organization.” ■

“Keeping track of what people are thinking, what they are seeing, and what they are feeling is important in times of uncertainty.”

— DAN RASMUS
MICROSOFT BUSINESS DIVISION

Deborah Asbrand is a senior editor for Triangle Publishing Services Co. Inc. of Newton, Mass. Her articles have appeared in The Industry Standard, The Boston Globe, Corporate Dealmaker, Forrester Reports, and MIT's Technology Review.

This research project was funded by a grant from Microsoft.

Microsoft

© 2009 The McGraw-Hill Companies Inc.
All rights reserved.