IT Budgeting for an uncertain 2011

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Introduction

The IT budgeting process for 2011 is more challenging than last year in that there are still hard decisions to make with how to achieve cost reduction without impairing vital services; but now, due to an uncertain worldwide economy, the overall business direction is uncertain. As we prepared this white paper, the DJIA is pushing past 11,000 but employment is not improving and international currency valuations are a growing concern.

Will the economy have a "double-dip," continue forward at a restricted pace or move forward in 2011 at a stronger pace? Will we face deflation or inflation or neither? Does economic activity face a "new normal" in which consumers focus on debt reduction and reign in spending for a protracted period of time?

And what does that mean for technology? Everyone wants to be on the "Cloud" but what does that really mean and will it really save money? Should we adjust our IT architecture and infrastructure to face the prospect of acquiring other companies? Should we bring outsourced services back in house or outsource even more?

This paper takes a look at the top possible scenarios and likely outcomes your company could be in and how each situation will impact your IT direction, priorities and budget, with final recommendations for business to effectively budget IT in 2011.

Background

IT budgeting in 2010 provided a similar challenge – how to achieve cost reduction without impairing vital services – but those challenges were associated with a *clear* direction for most organizations; thus, it was simpler to make the right budget decisions and the business plan was clear. As we approach 2011, however, IT budgeting is clouded by many questionable areas:

- Legacy systems are still seen as impeding the speedy delivery of innovative solutions;
- The Business IT wish list is still way beyond affordability;
- Pent up demand for IT innovations may open up in 2011;
- Focus is still on operational cost reduction;
- SaaS and the Cloud are seen as providing positive opportunities;
- New projects need a return in less than 12 months;
- Depending upon how the recession impacted the Business, there are variations to consider – is it emerging ready to grow, performing strongly or barely surviving?

Conflicting Expert Opinions

There are a variety of opinions among the experts. One major IT analyst's recent survey of business executives concluded that the window on IT cost reduction "may be rapidly closing" as the focus shifts to positioning for the economic recovery. A second industry monitor's survey indicated that less than half of the companies they examined are planning to increase IT operational budgets and almost one-fourth are expecting further decreases in the next twelve months. Not only is there a lack of consistent answers, but, as we will explore, the questions themselves can be very different for different companies.

How to Approach the 2011 IT Budget Process

We propose that IT budgeting for 2011 should begin by taking a hard look at the enterprise level business strategy, using that strategy to establish priorities among competing, and potentially contradictory, initiatives. Flexibility will also be particularly important as business direction may shift suddenly during the year.

The Business Challenges – Three Scenarios
Consider three potential situations your company could be in. Each situation will impact your IT direction, priorities and budget.

Case One – Ready to Grow
Company A came out of the past year in good condition. They were large and financially strong at the end of 2009 and have focused 2010 on seriously trimming the fat from all parts of the organization, including IT. They selectively pared staff, eliminated unneeded software licenses, delayed application maintenance and negotiated better terms from key suppliers.

Company A may be facing these issues for 2011:

§ Will executive business management seek to:
o Acquire smaller companies?
o Invest in new line(s) of business?
o Develop strategies to move quickly ahead of the competition?
§ Should IT respond to these needs via:
o Selective hiring of experienced personnel?
o Upgrading the company's enterprise applications?
o Moving aggressively to the cloud for customer facing apps?
o Investigating I-phone apps for internal and external use?
§ How should IT prioritize its initiatives?
§ Where should the 2011 IT budget dollars be focused?

Case Two – Survived with Strength
Company B struggled with the last 18 months but is internally stronger as a result. While the balance sheet continues to need improvement, the business mission is more precise. B has fine-tuned its focus, shed non-essential lines of business, trimmed assets to raise cash and focused heavily on retaining its core customers.

Company B may be facing these issues for 2011:

§ Will executive business management seek to:
o Increase revenue by competing more effectively?
o Increase profitability through further reductions in operating costs?
o Develop strategies to deepen business relationships with profitable accounts?
§ Should IT respond to these needs via:
o Improving its ability to provide Business Intelligence data and apps?
o Analyzing its revised costs to find another 5-10% of cost reductions?
o Investing in more web-based customer interfaces?
§ How should IT prioritize its focus?
§ Where can the 2011 IT budget trim costs and how should the remaining budget dollars be re-deployed?

Case Three – Barely Survived
Company C saw its core customer base erode as sales decreased dramatically. Cost reduction efforts continually lagged decreasing revenue. In hindsight, some

key technical skills were lost in the effort to maintain the business. Even now business executives are concerned that the bottom in their business activity has not been reached. Stronger competitors are poised to steal sales away and the board is talking seriously about selling the enterprise.

Company C may be facing these issues for 2011:

§ Will executive business management seek to:
o Continue decreasing operational costs?
o Make every effort to stabilize sales and fend off the competition?
o Develop strategies to find new capital via merger with a larger company?
§ Should IT respond to these needs via:
o Investing some scarce dollars in sorely needed business intelligence?
o Analyzing its remaining costs to find more reductions?
o Finally fix high priority operational problems to enhance the company's value to a potential buyer?
§ How should IT prioritize its focus?
§ How can the 2011 IT budget trim costs while simultaneously shoring up remaining deficiencies?

Getting from Point A to Point B Is Not the Same

In each of these very different scenarios the 2011 IT budgeting process faces the same basic issues – determining the focus points for 2011, prioritizing 2011 activities and balancing tactical and strategic needs against the reality of maintaining tight budget control or even reducing IT costs even further. But each organization's starting point – the company's current financial situation and corporate business strategy – is very different.

The objective of Brivea's recent survey of finance and information technology executives was to help identify that starting point from both a business (financial and competitive position) perspective and an information technology (IT capabilities and IT portfolio) perspective.

Brivea's Survey on 2011 IT Budgeting Outlook

Brivea conducted a survey among its own clients to gather direct data and opinions on the 2011 IT budget outlook. The survey responses are analyzed in the next two sections of this white paper.

Survey Participants' Demographics

Consistent with our desired population set (Finance and Information Technology Executives), only a few survey participants identified themselves as Business Executives (CEO, COO and others); the remaining participants were equally split between Finance (CFO, VP Finance and similar titles)and Technology (CIO, VP IT and similar titles).

Participants' industries included construction, education, healthcare, hospitality, insurance, manufacturing, non-profit, pharmaceutical, retail and utilities. Healthcare had the most participants and manufacturing came in second. The remaining participants were spread fairly evenly across the other industries. The sample size was sufficient from a statistical perspective and the even split between finance and technology executives provides a desirable balanced perspective.

<u>Presentation of Analysis and Conclusions</u>
Our analysis and conclusions are grouped between business factors and technology issues. *<u>Financial Findings</u>* are focused on relative spend levels on information technology (2010 versus 2011), potential business drivers relevant to the 2011 IT budget (investment strategy and focus, timeframe to achieve business benefits) and competitive factors (perception of IT as an asset, perception of IT capabilities versus competitors' perceived IT capability). *<u>Technology Findings</u>* are focused on the types of technology that may be invested in and deployed (the "IT portfolio") to achieve the desired results. Examples of such technology types are cloud computing, cyber security and virtual workforce tools, among others.

Key Financial Findings Relevant to the 2011 IT Budget

The following points analyze and summarize the responses to survey questions that are relevant to the overall financial and business backdrop for IT in 2011.

IT spending is likely to be higher in 2011 and 2012
§ 50% of participants agreed or strongly agreed that their IT spending will increase in 2011 versus 2010. Another 33 % were neutral or did not know. The remaining 17% disagreed.
§ 46% agreed that their IT spending would increase by more than 5% over the next two years. Only13% of participants disagreed.
§ 31% expect that their IT spending as a percentage of revenues will be about right. This implies that if revenues are expected to increase the IT budget will also.

However, many participants seem to believe that their current level of spending is neither overly constrained nor hurting the business:
§ 46% of participants agreed that IT funding has been appropriate during the past two years; 32% of participants disagreed.
§ 44% percent also believe that their IT capabilities are keeping them ahead of their competitors.
§ 53% believe that their customers are impressed by their IT capabilities.
§ However, 44 % believe that their IT capabilities are significantly constrained by their IT budget and
§ 77% state that their IT "wish list" is beyond their affordability in 2011.

So while recent past spending discipline may not have overly constrained IT, there appears to be a belief that IT could have a stronger positive impact if given additional funding.

On-going operations' budgets are likely to be the main use of expenditures:
§ Only 5% of participants agreed that IT operating budgets would be decreased to fund new projects.
§ Only 28% agreed that less than 50% of 2011 budgets would be for operating costs.
§ Only 27% agreed that if the ROI was well proven they could double the IT budget.

So IT budgets are likely to increase, but IT budgets are also as likely to be focused on operations as on new projects, even when the ROI for a new project is well proven.

Shorter duration projects are likely to be the case.

§ 50% agreed or strongly agreed that 2011 IT initiatives will focus on a business return within 12 months. Another 39% were neutral or did not know. The remaining 11% disagreed.

The match between IT expenditures and the achievement of business objectives is a point of inconsistency in our survey:

§ 56% disagreed that they have excellent processes for mapping IT investments to key business metrics and only 19% agreed;

§ Yet two-thirds agreed or strongly agreed that IT is a major asset to their business, 60% agreed that their IT investment decisions are business driven versus technology driven and 40% agree that their business and IT leaders plan projects well together.

§ 44% believe that their IT capabilities are keeping them ahead of their competition, versus 31% who do not believe that, and only 20% agreed that they envied the IT capabilities of their competition.

§ At the same time, 40% believe that their legacy systems are an impediment to moving forward with innovative IT solutions and only 27% believe their suppliers are impressed by their IT capabilities – a situation that can be a significant business risk.

§ Sixty-one percent believe they are spending their IT money "on the right things",

§ But an even higher percentage – 77% – state that their IT "wish list" is beyond their affordability in 2011.

Participants have strong opinions concerning their organization's ability to implement successfully, either positive or negative.

§ Only 13 % were either neutral or did not know. A slim majority (53%) had a positive opinion on their ability to implement on time and on budget, while the remaining participants held a negative view.

A majority of our participants believe they understand their IT costs and a significant percent believe IT investments are aligned with business objectives.

§ Two-thirds of our respondents believe they have "excellent visibility on how and where we spend money on IT".

§ Nearly three-fourths agreed or strongly agreed that "IT is a major contributor to achieving our key business metrics".

§ 66% believe that their IT investment decisions are business versus technology driven.

§ 62% believe they spend their IT money on the "right things".

Key Technology Findings Relevant to the 2011 IT Budget

Technology Findings

The following points analyze and summarize the responses to survey questions that are relevant to the Information Technology function for 2011 budgeting.

Overall IT capabilities are predominantly perceived as constrained by IT

budget and are not significantly different from competitors' capabilities.

§ However, a substantial percentage of participants disagreed with these views, indicating there is room for improvement in IT capability apart from IT budget issues.

§ 44% agreed or strongly agreed that their IT capabilities are constrained by their IT budget. However, 31 % disagreed, indicating they are less inclined to see budget as the main issue.

§ Although 37% disagreed that their IT capabilities are constrained by their IT function, 25% agreed that they are.

§ 40% disagreed that if the ROI was well proven they could double the IT budget, implying that budget is a constraint to economically sound projects; however a strong minority of 27% held the opposite view.

§ One-third of participants disagreed that they envy the IT capabilities of their largest competitors; but 20% indicated that they do envy competitors' capabilities.

IT capabilities as measured by best practices are perceived as strong.

§ 28% agreed or strongly agreed that they "have already reduced our IT operating costs to best-in-class for our industry" and 44% were neutral.

§ Fully 62% of participants state that they look beyond their own sector for best practices.

§ 53% percent believe they implement projects on time and on budget.

§ As noted above, only 20% of participants agreed that they envy the IT capabilities of their largest competitors.

The desire to use new and innovative IT solutions in the business is very high, but the capability to do so has limitations.

§ 62% are looking to 2011 as the time to accelerate the introduction of IT innovations ;

§ But 40% agree that their legacy systems are an impediment to moving forward with new innovative IT solutions, and

§ Over 77% of those surveyed agree that their IT wish list is beyond their affordability in 2011.

The use of outside services in the form of cloud computing and software as a service ("SaaS") is likely to expand, but additional outsourcing agreements get mixed reviews.

§ 40% expect to make more use of Software as a Service ("SaaS") capabilities.

§ One-third agreed that cloud computing is important to them in 2011.

§ Almost half (47%) disagreed that "we outsource too many IT services", implying that additional outsourcing could be considered, but 20% agreed that they already outsource too many services.

<u>Other Budget Areas:</u>

Our survey pointed out particular additional areas that may be important for companies to focus 2011 funding resources on:

Vendor management, particularly in a rapidly changing financial and technology environment, deserves more focus.

§ 80% believe they have effective relationships with key IT vendors and 47% believe they can influence their key IT vendors.

§ However, only 20% agree that vendors keep them well informed of impending cost changes while one-third disagree with that assessment.

§ Even with respect to technology changes, only one-third agreed that vendors keep them well informed of impending technology changes while another one-third believed they do not.

Data and IT infrastructure security is an area likely to receive more IT budget dollars in 2011.
§ A strong 77% of survey participants are concerned about the security of their data and IT infrastructure.

Supply chain capabilities may be an area of further investment, particularly considering the business risk incurred with supply chain failures.
§ Only 26% of those surveyed agreed suppliers are impressed with their IT capabilities and a mere 7% believe they are.
§ By contrast, 53% agreed that their customers are impressed with their IT capabilities and NONE disagreed with that view.

IT training for employees is an area that warrants consideration for greater investment:
§ 60% disagree that they train employees sufficiently on IT.
§ Although 47% agree that they "have a culture that embraces change and new technology," one-third disagrees with that assessment.

Support of a flexible and/or virtual workforce will be important in 2011.
§ Almost one-third (31%) of those surveyed agreed that this will be important to them in 2011 while only 15% disagreed.

Survey Findings Summary

2011 and 2012 IT Budgets Increase:
Our survey indicates that IT budgets are very likely to be greater in 2011 and 2012, potentially more than 5% greater over that period. Many participants believe they are competitive with respect to IT capability and are spending the funding they do have on the right areas.

Disconnect Between IT Expenditures and Business Objectives:
However, the match between IT expenditures and the achievement of business objectives is a point of inconsistency. Some companies may believe they are doing a good job here while others may have concerns. The belief by a strong minority that recent IT budgets have been appropriate and may even have better aligned them with best practices would forecast a conservative approach to funding increases in the near term.

New Projects Must Prove ROI:
Budget increases are as likely to be used to support on-going operations as they are to fund new projects. Projects will need to achieve a return with 12 months and be clearly aligned with business objectives.

Unclear if IT Budget Constraints Impacts IT Capabilities:
Our survey indicates that some fundamental conflicts are at play. There is a disagreement between those that believe IT budget has been a constraining factor on IT capabilities and those who do not. Some participants may see the recent budget cutbacks as a positive that brought them in line with best practices.

However, there is also a very clear desire to implement new and innovative IT solutions together with a recognition that the entire 'wish list' cannot be paid for at present.

On-going Operations Gets Budget Support
Our financial findings indicated that on-going operations will receive a strong portion of any budget increases. Those funds could be deployed to improve ROI from IT by making more use of software as a service and cloud computing, focusing on improving supplier related IT capability and improving data and infrastructure security.

Investments Must Be Aligned with Corporate Strategy
Outside of on-going operations, IT could also take better advantage of its key (IT) vendor relationships to gain more visibility on upcoming technology changes and pricing. New projects should require a well-defined business case with a rapid attainment of business benefit.

IT Succession Plan Needs Attention
Legacy systems need attention, but our survey indicates that this is likely to occur in a piece by piece fashion making use of newer technologies to achieve discreet but rapid results.

Conclusion

2011 Budget Should Both Support and Initiate Business Strategy
The prospect of a prolonged recovery with high unemployment and a "new normal" adds a dimension of uncertainty to corporate strategy and budgeting. IT budgeting for 2011 is likely to be higher, perhaps in the high single digits over the next 2 years for some companies. Nonetheless, IT expenditures and investments must still be as tightly aligned with corporate strategy as possible.

As always, understanding the overall economic picture, the corporate strategy and the technologies available to address specific needs will be important to establishing IT direction and focus for 2011. IT may have to embark on seemingly contradictory initiatives in order to achieve strategic corporate objectives while maintaining flexibility. Direction and focus may well be different for companies within the same industry based on their relative strength, prior success in controlling / reducing costs and technological capabilities.

We anticipate that IT organizations will continue to focus on improving on-going operations, strengthening infrastructure and taking advantage of newer technologies on a selective basis with an eye to discreet projects with a clear business ROI that can be successfully achieved in less than a year.