



# Avoiding the austerity trap

By Bob Suh

In today's uncertain business climate, IT investment is often in the budgetary crosshairs. But in fact, now is the ideal time to upgrade existing infrastructure and invest in next-stage technologies that create value.

Management decision making can be fairly straightforward when the economy is clearly headed in one direction or the other. When it is growing, business leaders invest to meet demand. When it is shrinking, they cut costs to meet quarterly earnings expectations.

But what do executives do when the economy has bottomed out and growth is somewhere on the horizon but not yet robust? When the obvious cuts have been made and pricing power is a distant memory, how do companies continue delivering shareholder value while they wait for vigorous growth to kick in? What will it take to achieve high performance in these uncertain times?

And speaking of costs, what role does a capital-intensive function like information technology play in this quest for high performance? Many business leaders are understandably wary of IT investments. Although spending on information technology has increased substantially in the past 10 years, many technology projects have been characterized by sketchy metrics, long cycle times to new products and unpredictable results. No wonder many executives have come to regard IT investments as a necessary evil and information technology as something to be managed and purchased like any other commodity or utility.

Accenture holds a broader, decidedly more positive view. We believe that technology investment is vital to driving future productivity and growth—hence, it is critical to achieving high performance. And this investment can, in fact, be managed with discipline and rigor, which leads to increasing predictability and decreasing cycle times. Greater discipline in IT investments will enable companies to attain superior cost positions, which, in turn, can be used to gain market share, bring new products and services to market sooner, and serve customers with deeper insight.

### **Investing to capture value**

Companies that achieve high performance through technology understand this. They execute to take full advantage of the IT investments they have already made, for both short-term gain and long-term competitive advantage. This forward-looking approach to IT investment is based on their understanding of information technology itself, which they see evolving along a path similar to those taken by earlier transformative technologies. This understanding, in turn, positions the companies to

combine the significant investments they have already made in basic applications, communications and computing infrastructure with investments in newer value-creating technologies as they emerge.

The late 1990s produced a number of technology breakthroughs, which led to improved performance at lower prices. At the same time, technology suppliers increased their capacity. Now, in their own struggle to keep and gain market share, many of these suppliers are offering significant incentives—which means this is the ideal time to invest in next-stage technologies built on existing infrastructure.

High-performance businesses have a perspective on technology investment that sets them apart. They watch for opportunities to create business value in the short and long terms—and make a careful distinction between spending and investing.

These businesses avoid the austerity trap that is sending too many companies into a downward spiral. This trap is triggered when companies, responding to short-term pressure for greater earnings and convinced that information-related technology cannot create value, focus on cost cutting. As new technology projects are cut, hardware and software are replaced only when they fail or expire, so all components in the technology portfolio become older and less efficient.

An Accenture study<sup>1</sup> reveals that most companies have reduced their technology reinvestment by half in the past three to four years. These companies are allowing their IT

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<sup>1</sup> "Business Value Creation Through IT," Accenture 2003.

infrastructure to decline. An outdated, poorly maintained infrastructure cannot be the foundation for efficient current operations, much less competitive advances.

In contrast, high-performing companies look beyond cost alone to the total impact of a technology project—to its ability to help build a superior cost position and faster response times and, as a result, greater market share. When they consider cost, they take the broad view. For example, they look not just at purchase cost but at total cost of ownership over time. Or they look at the annual cost savings and other benefits (such as improved security) that can result from upgrading to newer technology. And these companies measure investment and risk so rigorously that they are able to predict from past experience which projects will exceed return-on-capital hurdles.

### **Virtuous circle**

As a result, they invest actively and with confidence, managing and upgrading their technology portfolios to capture value. According to the Accenture study cited above, companies with the best earnings growth reinvest up to 10 percent more of their technology budgets on upgrading to newer technologies than do companies with average earnings growth. Operating in a virtuous circle, these high-performing companies create the conditions necessary for continued superior earnings growth and competitive advances.

Finally, high-performing companies invest strategically, looking for ways that technology can help create competitive advantage. True, this advantage may not last, as competitors replicate their practices. But a short- to medium-term advantage can turn into a long-term advantage

if the financial gains are reinvested in making the next advance. High-performing companies invest and reinvest to stay one step ahead.

### **IT factories**

High-performance companies also have a different approach to the procurement of technology solutions—an approach based on the model of the manufacturing sector.

Manufacturing has evolved through a number of transformative changes in its long, complex history. Two are especially relevant when using manufacturing as a model for IT procurement. One was the movement from craft shop to factory, which involved the consolidation of skilled workers at a shared location, where they could make use of replicable processes and reusable components. The other was the movement of production capacity overseas, which has taken place largely in the past 40 years and is primarily driven by the desire to take advantage of lower labor costs.

For information-based technology, these two changes are poised to happen simultaneously. Think of the role IT plays for the expanding service base of the economy of the developed world. Rather than designing and assembling cars, the IT function must design and assemble services like online stock trading. If an investment firm builds its Internet stock trading capability at too high a cost, margins are sacrificed. If it builds the capability too slowly, market share may be lost. How can a high-performance solution be developed quickly and at low cost?

The answer lies in the manufacturing model. In information technology today, replicable tools and processes do exist. Leading practi-

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tioners are assembling the necessary staff, tools and techniques in concentrated development centers that are, in effect, IT factories. These centers may be wholly owned by a corporation, or they may be partially or wholly contracted with another company.

Furthermore, because of the ease and efficiency of global communications, corporations are finding it increasingly feasible to send portions of this information-based work offshore. The advantage can be not only reduced costs but a faster production cycle, especially if work centers are located at points around the globe that enable the work itself to “follow the sun,” with some part of the team always awake and at work.

This industrial/outsourcing approach to information technology is still relatively new. To date, only a few leading companies have begun to create factorylike information technology centers. And the movement to offshore outsourcing is still relatively modest.

Only about 14 percent of application outsourcing and less than 3 percent of systems integration and custom-application development goes to India, which is the dominant offshore technology source. Furthermore, when companies do outsource or move technology operations offshore, their primary goal is lower labor costs, which is also the almost exclusive focus of their metrics.

## When technology is more than just another commodity

A number of skeptics have argued that information technology has become just another commodity and that its value, especially as a change agent, has already been realized. It is undoubtedly true that a great deal of information-related infrastructure is in place, especially web-based interconnectivity, and that having fundamental technology capabilities is a basic requirement for nearly all businesses.

Some businesses, however, are using this technology with greater efficiency and effectiveness. Consider, for example, the performance differential in selling, general and administrative expenses, which account for anywhere from 35 cents to nearly 50 cents of every dollar spent on traditionally defined IT.

According to Accenture analysis, the SG&A spread between the lowest- and highest-performing companies in the chemical sector is 105 percent. In automotive parts that spread is 153 percent, and for computer OEMs it is 238 percent. The breadth of those spreads suggests that many companies can get much more value from their current technology, if only to improve current operational effectiveness.

Some high-performing businesses are achieving a true competitive advantage. AFLAC, for example, has a dominant

position in Japan: It insures one in four Japanese citizens, and 95 percent of listed Japanese companies offer its products to their employees.

How has AFLAC, a Georgia-based company, succeeded in a characteristically closed foreign market? Technology plays a major role. AFLAC handles most of its business online. Technology enables the company to settle product and process claims without costly agents and claims processors. As a result, AFLAC's cost to acquire and process a new customer is \$72 versus \$120 for its Japanese competitors. The company's early investments in Internet technology have enabled it to communicate with, sell to and service Japanese companies and their employees.

Some companies are moving forward with new technologies. In retail, for example, Wal-Mart, the world's category leader, and its major European counterparts have recognized that radio frequency identification device technology is maturing to the point of delivering real value, and they will be integrating it throughout their supply chain over the next few years.

As a result, technology today, like manufacturing in the past, incurs extremely long cycle times to new products. Defect rates are often high, and inventory and capacity inefficiencies abound.

Yet those leading companies that have moved toward this new industrial/outsourcing model are already reaping the benefits. Consider, for example, General Electric, which has applied its manufacturing and global sourcing discipline to the management of IT and back-office processes. GE was among the first large companies to establish 24-hour customer service and IT operations. It took an early lead in India, due to both labor savings and the time-zone difference, which made it possible to offer 24-hour service and support. GE has even invested in R&D facilities in India. Currently, the company mandates that quotas be met in sourcing certain percentages of IT work globally.

### **Strategic delivery**

The value of strategically locating delivery centers around the globe goes well beyond cutting costs. Accenture analysis suggests that this industrial follow-the-sun model can decrease project cycle times by 30 percent (and up to 50 percent for some applications delivery processes) and increase existing programmer productivity by 30 percent. Cutting the production cost and cycle time of IT projects, while also ensuring that quality outcomes could be delivered on time and within budget, would propel companies into significantly higher performance and higher earnings positions.

There is an important caveat that should be part of any discussion of this industrial model for technology procurement, particularly when the outsourcing component of this

model is driven largely by cost savings. History has demonstrated that the advantages of labor arbitrage seldom last forever. Moreover, plentiful labor is not a guarantee of skilled labor. Any advantage derived from labor arbitrage will ultimately be outweighed in value terms by accelerated cycle times, reduced defects and greater flexibility. This was a lesson learned by post-war Japanese manufacturers. Once they lost their status as low-cost producers, they began to reinvest in their plants and embrace automation.

Corporations are in an analogous situation today when it comes to investing in IT infrastructure. This investment will still be creating value long after the benefits of any labor arbitrage have ended.

IT infrastructure continues to play a vital role in high performance. To cut cycle times, companies need to manage work across IT suppliers, business partners and geographies securely, in real time, and with high availability. This will require changes in corporate data centers, software and networks. And, as radio frequency identification devices and mobility solutions are embraced, infrastructure becomes the critical foundation for delivering them securely. Moreover, the very definition of infrastructure will be broadened to include high-technology devices that can deliver new value on the existing platform (see sidebar, page 60).

Does that mean still more investment in infrastructure? Yes. It is important to note that at many companies, although major portions of the infrastructure have been built out, other elements often have not been. For example, companies may have built core network capabilities to support communications between locations,

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but they may still need network infrastructure to support wireless communications from individual devices.

Furthermore, there is real danger in not investing to maintain the infrastructure already in place. Consider this analogy. Great Britain invested heavily in its railroads during the 1960s and reaped the rewards for many years while deferring maintenance and upgrades. Performance and financial returns were good enough that no one asked whether results would be even better if the system were being continuously upgraded. In fact, infrastructure quality was slowly declining, and by the 1990s, safety systems had become inadequate, accidents were on the rise, trains were arriving late and service was being cut. Massive investment again was

needed. Corporations will want to avoid the same costly deterioration in the quality of their IT infrastructure.

Although more infrastructure investment may be needed, there is good news: Payback is in sight.

Most executives, though they lack concrete evidence, are convinced that returns on such investments have been poor. To some extent, this is true, and the executives' attitude is understandable: As new web-based and enterprise applications were approved in the past 10 years, a significant part of the new project costs required infrastructure upgrades. New web servers, security software, networking equipment and desktop upgrades all added to the hurdle rate of technology projects.

## Old infrastructure meets new technology: The digital pen



Marrying a company's existing infrastructure to market-ready new technologies can create genuine economic value. Accenture Technology Labs is exploring technologies for their impact on the high-performance enterprise. One of those technologies, the digital pen and paper, offers a good example.

Digital pens work much like ordinary pens, but they also are embedded with electronics capable of storing time-stamped content. The data stored in the pen can be transmitted via the Internet to a central server for further processing, storage and analysis. Accenture estimates that in retail banking and insurance, paper processing costs could be reduced sixfold through the use of these devices, and that the time needed to open new accounts or policies could be speeded up significantly.

In any paper-intensive industry—financial services, health care, manufacturing and government operations come to mind—a digital-pen solution could be a relatively straightforward add-on without the need for expensive capital investment in portable computers and system training.

Many of these upgrades have now been made, however, which means the returns on future projects will be higher. Although newer technologies will require some additional investment in infrastructure, most companies will be leveraging significant prior investments. And increasing the number of applications leveraging the infrastructure will raise firms' returns on their invested capital.

Companies must also integrate software, tools and standards to achieve higher returns and lower cycle times. They must leverage web services and enterprise integration tools to reuse applications and increase integration. And they must continue to take advantage of the investment in packaged software to adopt process best practices rather than develop and maintain them on their own.

Finally, high-performance companies must continue to value technology innovation, both at the front end, where information technology operations themselves are designed and executed, and at the back end, where information-based products and services perform in the marketplace.

The best companies innovate with an eye toward strategic goals. That may mean investing in new technology, or it may not. What is clear is that these companies have a superior ability to discern important industry drivers of present and future value, and to combine that insight with an understanding of how information-based technology can contribute to differentiated operating models and business architectures.

They recognize that technology can power significant incremental earnings through cheaper and better customer service, more effective cost of goods and services, and more

productive SG&A functions. They also recognize the value of existing IT investments as a platform for leveraging emerging technology. The result might be a new product, service or business model that takes advantage of the power of an integrated infrastructure.

Many companies, with a little more effort, can achieve significantly greater returns from their technology investment. Ultimately, of course, on your journey to high performance it is what you do with technology that matters—how creatively you put it to work, how diligently you build on it and how prepared you are for the next genuine breakthrough. ■

### About the author

**Bob Suh** is the Boston-based managing partner leading strategy for Accenture's global Technology & Outsourcing business. He is a member of the Accenture Technology & Outsourcing Executive Committee, which governs the company's business in software, applications, core technologies, global software development and infrastructure.

[bob.suh@accenture.com](mailto:bob.suh@accenture.com)