

How low should you go?
How the UK's leading
organisations are cutting
IT costs



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How low should you go?

As large corporations and government departments experience increasing pressure to control their costs, IT expenditure is under ever closer scrutiny. In order to uncover and explore different organisations' attitudes and approaches to IT cost reduction, Deloitte surveyed 60 major IT users in the UK private and public sector.

As we expected, we found that a large majority of organisations were actively reducing IT costs, although a significant minority had yet to act.

Some of our other findings were rather more startling.

For example, our survey shows that in many cases IT savings targets lack ambition, falling well behind best practice and often representing little more than the savings that will inevitably occur as business activity declines in the current recession. Surprisingly, most CIOs are not involved in setting their own IT cost reduction targets, but are instead responding to enterprise-wide cost reduction targets set by the CFO or COO.

More encouragingly, our respondents are employing a wide range of cost reduction tactics, but it is interesting to note that in most cases our respondents are asking their IT suppliers to deliver a greater share of savings than they are prepared to demand from their in-house IT teams.

Nevertheless, significant headcount reductions do feature strongly, affecting both contract and permanent staff. In most cases these savings come at a cost, affecting the service IT delivers to the business as projects are cancelled and organisations are increasingly forced to rely on out-of-date infrastructure. Even more alarmingly, a significant minority of organisations are reducing service levels to their users, and in some cases even cutting back on disaster recovery.

In this report we provide a detailed breakdown of our survey findings, giving an insight into how some of the UK's largest organisations are managing their IT costs in the face of the ongoing economic downturn.

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Methodology

The Deloitte survey on IT cost reduction was conducted in March 2009 and surveyed a total of 60 respondents at major public and private organisations. The survey examines the latest trends and approaches on IT cost reduction.

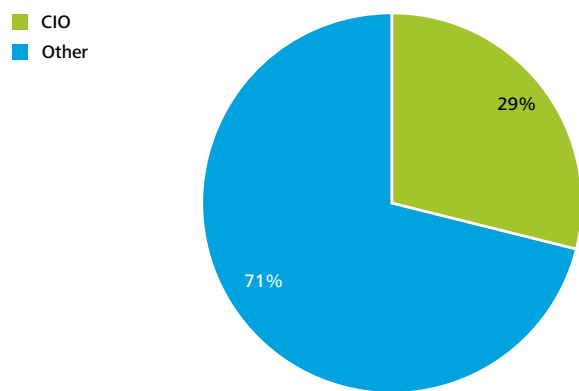
Time to take control

Perhaps surprisingly in the current market conditions, approximately a fifth of our survey respondents have yet to undertake an IT cost reduction project. Of those organisations that are engaged in IT cost reduction, our survey highlighted a lack of ambition, with most aiming to achieve savings of 10% or less. Savings targets are often set without the CIO's involvement and are focused on delivering short term benefits. Our conclusion is that IT is reacting to business pressure by delivering short-term tactical savings, rather than taking control and driving greater long-term benefits.

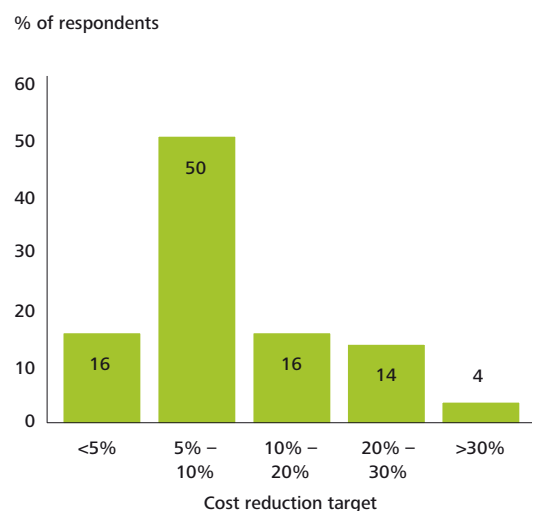
Among those engaged in IT cost reduction initiatives, nearly three-quarters have had savings targets set outside the IT organisation, typically by the CEO, CFO or COO. While it is encouraging to see that IT costs are being managed as part of wider enterprise cost reduction programmes, the lack of CIO involvement suggests that cost reduction targets are being dictated by individuals with limited understanding of the costs, risks and issues associated with IT service delivery.

Interestingly, this is resulting in IT cost reduction targets that are typically far too low, with 66% of respondents demonstrating a distinct lack of ambition by targeting savings of 10% or less. In a shrinking economy, IT costs will inevitably fall to reflect the reduced demand for IT services from the business. This reducing demand means that savings of 10% or more should be the starting point for IT cost reduction, not the ultimate goal, and more CIOs should be joining the 18% of respondents aiming to save 20% or more.

Who determined/determines your IT cost reduction targets?

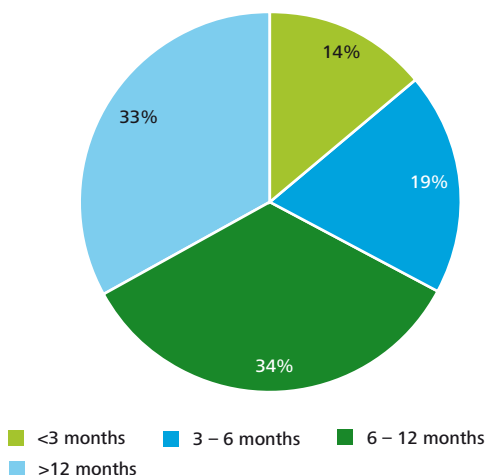


What IT operations cost reduction target are you hoping to achieve from your current IT cost reduction initiative?



Two-thirds of organisations are taking six months or more to complete their cost reduction programmes, and most are expecting to reap the benefits over a 1-3 year horizon. This thoughtful approach is also reflected in the 64% who claim to be looking for a combination of short-term tactical savings and longer-term strategic savings. However, there is a significant minority who expect to complete their cost reduction activities in six months or less. This tactical approach is unlikely to deliver sustainable savings, which perhaps explains why 37% of respondents are embarking on an IT cost reduction programme less than a year after their most recent such effort. So while many organisations are working towards the sound goal of achieving strategic long-term savings, for others the focus is on getting cash in quickly. This is supported by Deloitte Research which indicates that new bank borrowing will remain both costly and difficult to obtain; so freeing up cash from the business remains a priority.¹

How long did it take to complete your last cost reduction programme?



“All decisions related to IT cost reduction at present must have a short pay back period (less than six months) in order to gain support for execution. This is driving tactical decision-making; pushing the Business towards a continuation of the fragmented estate which it traditionally operated.”

Survey respondent

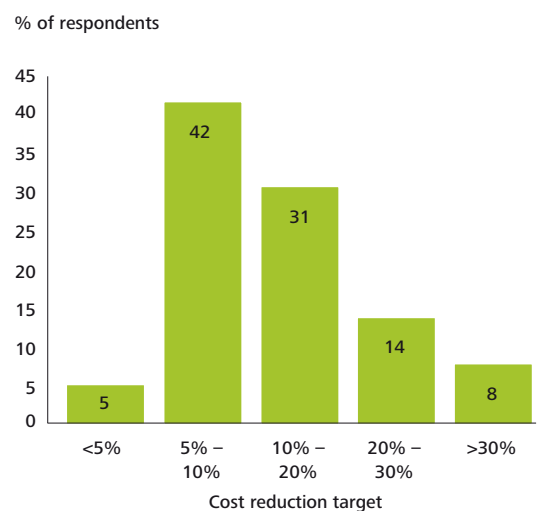
Passing the buck?

When asked to cut IT costs, the first reaction of most of our respondents is to call in their IT suppliers and ask them to 'share the pain'. Cutting permanent and temporary headcount also features prominently. But sustainable IT cost reduction involves more than simply leaning on vendors and cutting staff. Some of the more strategic approaches we found included improved demand management, a renewed focus on outsourcing and rationalisation of the enterprise architecture. The table below lists the tactics employed by our participants.

Category	Percentage
Third-party contract negotiation or re-procurement	72%
Outsourcing	58%
Improved demand management	56%
Permanent staff reduction	54%
Changing the enterprise architecture	52%
Contract staff reduction	52%
Freeze on new projects/abandoning current projects	48%
Offshoring	32%
Reducing energy use	26%

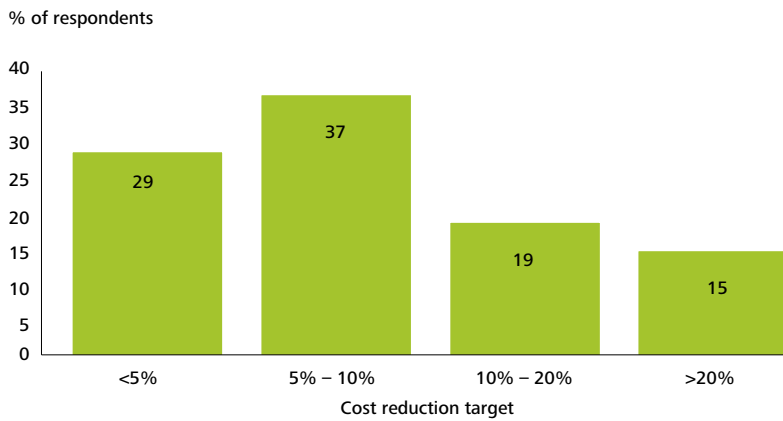
The most obvious IT cost is third-party spend, so it is perhaps not surprising that 72% of our respondents are expecting their suppliers to reduce their prices. It is interesting that while most organisations are setting overall IT cost reduction targets of only 10%, the majority of our respondents are expecting their suppliers to be able to save much more than this, perhaps 30% or more. It will be interesting to see how the supply market responds to this kind of pressure. There will certainly be a risk that suppliers will under-invest to recoup those savings, impacting service delivery. For suppliers, seeing the threat of falling revenues at a time when their own cost of capital is increasing may create real issues with their own profitability, provoking a robust response to requests for additional discounts.

If you are reducing third-party expenditure, on average, what IT cost savings are you looking to achieve from your suppliers?

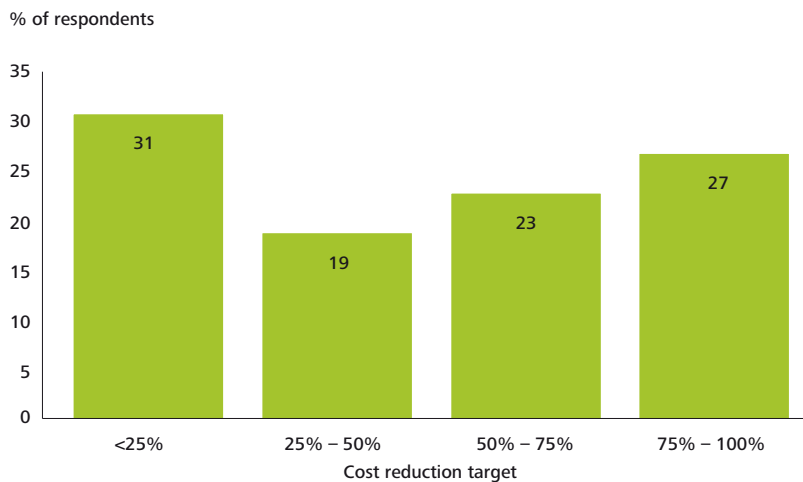


Headcount reduction is another obvious area of attention. Half of our respondents are planning to cut their contract headcount by between 50% and 100%, and many organisations are also reducing contract rates for those who remain. Permanent staff are also affected, and one-third of firms are planning to cut their permanent headcount by more than 10%. Although this can seem like a 'quick win', we also found evidence that for some organisations the cost of redundancies is a barrier to reducing permanent headcount. This may be a good thing; IT skills are scarce and organisations that have not retained the skills they need may have real challenges attracting new staff when markets strengthen, particularly if they have a 'hire and fire' reputation.

By how much do you expect to reduce your permanent IT headcount?



By how much do you expect to reduce your contractor IT headcount?

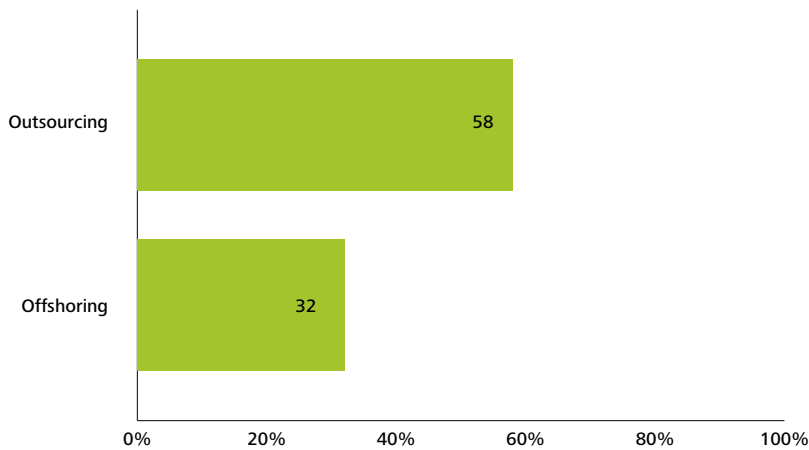


Outsourcing is a well established approach for delivering IT infrastructure, network and application management services. Although this seems to be a mature market, a large proportion of our respondents indicated that they are planning to outsource more to reduce costs further. Although this is a proven approach, it is hard to reconcile this with the relatively short timescales that organisations are allowing for their cost reduction programmes, as major IT outsource arrangements typically take more than a year to complete. While offshoring did feature as a tactic, there was less enthusiasm for this.

“It is difficult to get third-party supplier buy-in to support our objectives and deliver the same services at a reduced cost.”

Phil Pike, Director of IT and Procurement –
Wales & West Utilities

What tactics are you employing to reduce IT costs?



Although we are supposedly living through the days of ‘Green IT’ and a period of fuel price volatility, reducing energy usage was the least popular cost reduction tactic. This perhaps reflects the reality that while this is a newsworthy topic, energy costs still only form a small proportion of the overall IT budget.

Risky business

Organisations are willing to take some significant risks if this will result in major IT cost savings. We are likely to see projects being cancelled and an increasing reliance on ageing infrastructure, leaving IT departments and businesses facing the risk of declining service and a backlog of work to do when business confidence and investment returns. Greater reliance on increasingly challenged suppliers will also bring a different set of risks.

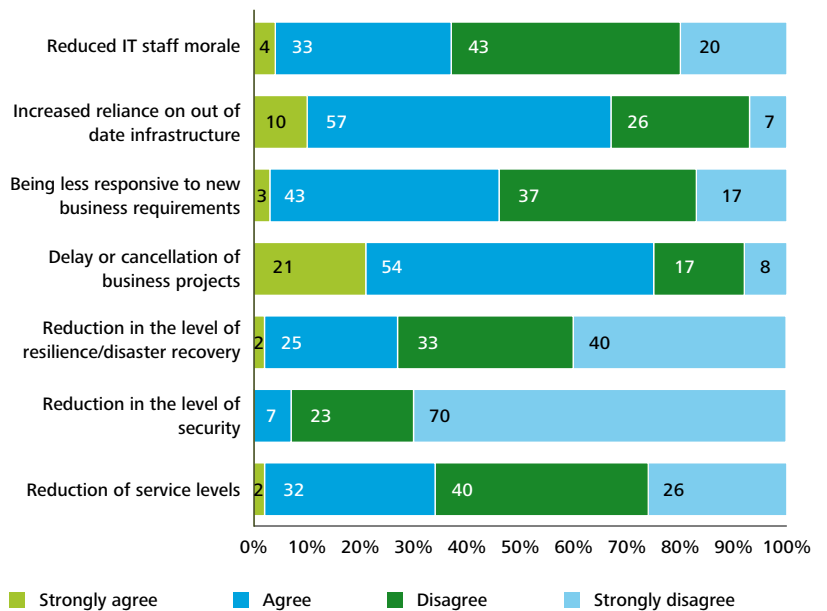
With around two-thirds of respondents showing a willingness to cancel projects and rely on out of date infrastructure, the ability of IT to support the business is in danger of being compromised. While few would be prepared to compromise IT security, a significant minority concede that service levels and disaster recovery could be impacted in the hunt for IT cost savings. Operational risk may not be the only consequence; there will also be pent-up demand for new investment that will need to be made when business conditions improve, creating a different set of challenges for those organisations that have cut back on their IT staff.

While outsourcing is firmly in vogue, most realise that this brings another set of issues. Over 90% of respondents recognise the risks associated with currency fluctuations and the stability of vendors. These are both recent developments that did not feature as a major concern only a year ago. Protection of customer data is also an issue, and most also see the potential for future geopolitical events to impact IT operations that are moved offshore.

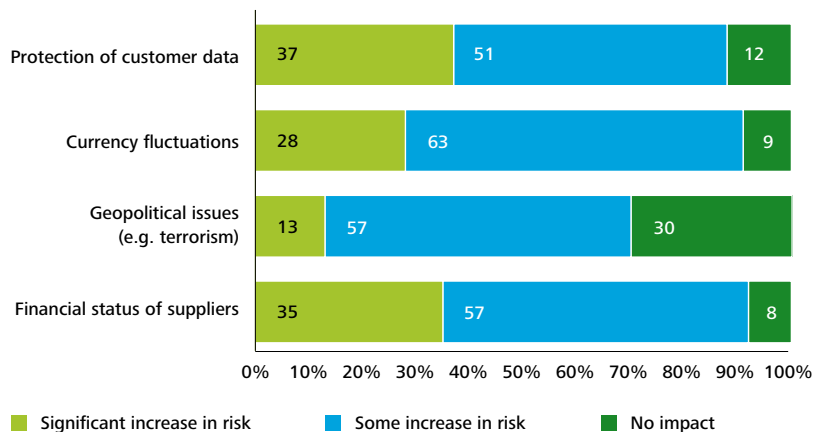
“Our biggest challenge is balancing cost saving initiatives against the need to continue growing the business and deliver client-driven projects.”

Keith Harrison, Senior Director, IT Operations – TSYS International

Compromises I would accept in return for substantial IT cost savings include



Perception of risk associated with outsourcing



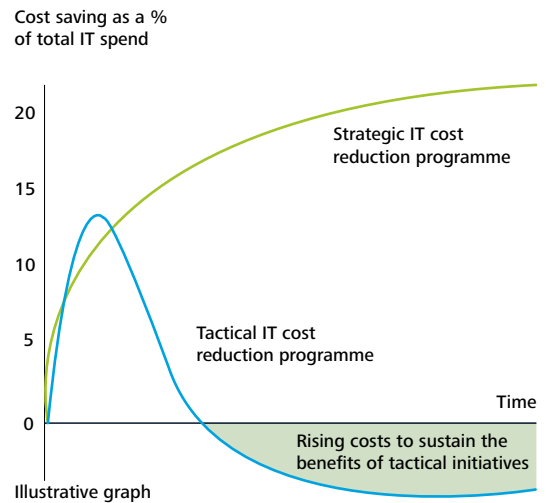
Light at the end of the tunnel?

While IT costs are clearly under pressure, most organisations are responding positively. It is disappointing though that IT leadership seems to be reacting to cost challenges rather than leading from the front, and the largely tactical focus on relatively modest savings may store up some issues for the future. Nevertheless, we are encouraged by some of the good practice we found:

- **There is a strong focus on demand management.** At Deloitte, we view this as an absolutely key area of focus, with effective management of business demand backed up by internal IT recharge mechanisms playing a major role in containing IT costs.
- **Achieving business buy-in is essential.** Many of the survey participants highlighted the efforts that the IT team is making to ensure the business backs their cost reduction plans. This is a critical area, as any trade-off between cost and service must have the support of IT customers.
- **There is a strong service culture within IT.** Many respondents commented on the efforts they are taking to preserve service levels and avoid short-term operational issues. While this is laudable, it is questionable how long service can be preserved with ageing assets, fewer staff and little new investment.
- **Outsourcing is being used as a strategic cost reduction tool.** While it does bring some new risks and must be effectively managed, outsourcing is a sustainable approach that can deliver real long-term benefits.

At Deloitte, our own view is that it is absolutely right to focus on IT costs. Our client experience has shown us that there is often potential to achieve sustainable savings of 30% or more without resorting to short-term 'slash and burn' tactics. We would encourage a strategic approach that avoids damaging vendor relationships and losing key staff, instead combining some of the good practice we describe above with improved governance.

Cost reduction: Taking a strategic view



Most importantly, the starting point for any cost reduction programme is to have a clear, detailed and definitive view of IT costs and a well structured plan for managing and tracking cost savings. Only then can you be sure 'how low you should go'.

There is potential to achieve savings of 30% or more without resorting to short-term 'slash and burn' tactics.

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