



New Math for IS

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Layout/Production: Gartner Corporate Marketing

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Foreword

IS's role is evolving to be more business based. Maintaining IS-business alignment through this evolution requires appropriate financial techniques. Annual budgeting can be improved and augmented to provide the IT funding flexibility enterprises increasingly need.

Annual budgets are today's near-universal means of providing oversight, transparency and direction for most IS organizations. Many CIOs have invested time and political capital to hone their IS budgets. As one CIO says, "Budgets are not something I agonize over any more."

But annual budgets can foster the wrong behavior. Worse yet, as IS increasingly offers business services, budgets can limit options.

How can CIOs improve IS financial approaches for today and tomorrow? This Gartner EXP research, led by Andy Rowsell-Jones and Marcus Blosch (Gartner vice presidents and research directors), provides an answer.

Many organizations and individuals from around the world contributed to this work, including:

- Gary Vickers, CSR; Arvind Tawde, Mahindra & Mahindra; David Trende, Melbourne Business School; Marj Akerley, Natural Resources Canada; Gian Piero Pepino, SEAT; Giancarlo Miglio, Siderca – Argentina; Stig Johansson, SKF Group; Probir Mitra, Tata Motors; Tony Cicco and Cynthia Heckmann, U.S. Government Accountability Office; Corey Booth and George Eckard, U.S. Securities and Exchange Commission.
- Other members of the Gartner EXP research team: Dave Aron, Richard Hunter, Trish Jaffarian, Mark McDonald, Tina Nunno, Chuck Tucker and Barbara McNurlin, adjunct researcher.
- Other Gartner colleagues: Steve Bittinger, Jean-Marc Lejeune and Steve Weber.

Executive summary

IS is providing more business services. To keep in step with the business, now is the time to review and augment IS's financial approaches.

IS's financial approaches need to keep pace with IS's evolving role

IS's approach to financial control needs to keep pace with IS's evolving role. IS can do this by evolving its financial disciplines through five stages.

Stage 1: IS spending is a “black box.” The IS budget is a single number. Business management does not know how the budget is spent.

Stage 2: IS spending is a “glass box.” The IS budget is still a lump sum allocated as the CIO sees fit, but business management has some input.

Stage 3: IS spending is a simple portfolio. The budget has two goals: Keep the lights on and invest in the business.

Stage 4: IS spending is a comprehensive portfolio; IT is viewed as an investment portfolio.

Stage 5: IS spending is an enterprise portfolio; IT expenditures are business expenditures.

As an IS organization evolves from black box to enterprise portfolio, what constitutes appropriate oversight, transparency and direction also changes.

Oversight generally includes issues such as supervision (how the budget is managed) and expectation (disclosure expectations). For example, supervision can range from a budget that's set in concrete each year to one based on expected returns. And expectation can range from one that's set only as an

expenditure level (with no other expectations) to one that accommodates improvements in business performance.

Transparency refers to how much information about the budget and spending allocation is released to the business and the level of consultation that goes with it. For example, disclosure ranges from little or none, to full disclosure and active participation by the business in setting the budget and its individual project objectives. And consultation ranges from minimal, to ongoing controls that are built into business unit plans.

Direction covers control (how much is allocated to the IT budget) and planning (what the budget is supposed to pay for). Control ranges from an annual spending limit to viewing IT as a normal commodity that must be paid for. Planning ranges from autocratic control of the IT budget to a mix of finely subdivided portfolios.

Improve today's IS-business alignment by addressing short-term barriers

Three budgetary barriers block IS-business alignment today.

Today's oversight barrier is an insufficiently granular IS budget. While black-box (stage 1) and glass-box (stage 2) IT budgets give CIOs some control and flexibility, they can distort allocation. For example, one CIO notes that equipment to upgrade the infrastructure was delivered early, then used for short-term replacement; so when implementation arrived, they had to make an emergency funding request. If the IT

budget had been a single figure, or a stage-3 simple portfolio, this repurposing of assets would have been invisible to business management.

Today's transparency barrier is an inability to link IS to business services. When only the CIO and CFO handle the IT budget, other executives cannot help set priorities. There are three ways to increase transparency: Clarify cost drivers, use meaningful categories, and disclose appropriate levels of budget detail.

Today's direction barrier is IS not taking ownership of the IS budget. One way to improve staff ownership of the budget is to force them to consider the budget when making decisions.

Overcoming the oversight, transparency and direction barriers improves IS-business alignment today. Other techniques can improve tomorrow's alignment as IS's role evolves.

Improve tomorrow's IS-business alignment by addressing long-term barriers

Three different barriers will get in the way of future IS-business alignment. Each has at least one potential solution.

Tomorrow's oversight barrier is that IT portfolio budgeting rules will limit IS's range of options. Also needed are decision rules and funding sources that allow funds to be moved around without requiring major budgetary revisions. Likewise, budgetary flexibility requires finer budgetary controls. Both issues can be addressed with more granular portfolio budgeting—by clustering IT investments into

appropriate categories with different governance, budgeting and tracking rules for each.

Tomorrow's transparency barrier will be insufficient clear cost drivers. Often, IS has a peak-and-valley workload. Activity-based costing (ABC), which aims to identify the costs of performing activities under different circumstances, is one technique that can help.

Tomorrow's direction barrier will be the annual budget. Annual budgets are no longer appropriate decision-making vehicles because they cannot keep up with the fast-moving business environment. And they can impede multiyear budgeting. The concept of “beyond budgeting” can address this barrier. Using it, managers have incentives to deliver incremental improvements.

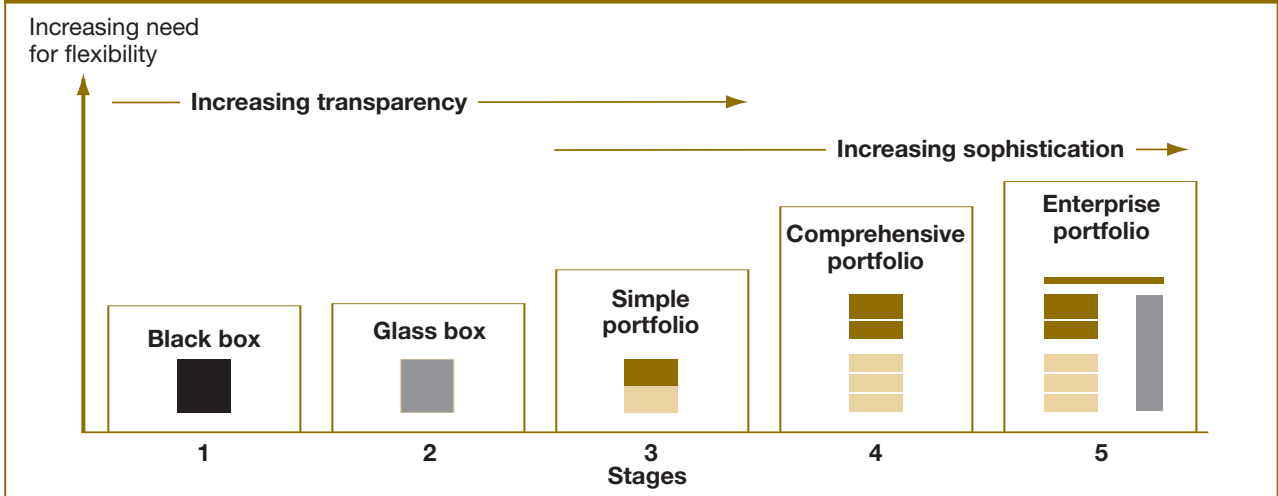
Augment budgeting processes—Don't abandon them

Implementing changes to financial approaches depends on three key behavioral areas.

First, recognize stakeholders' different perspectives. Second, build consensus for change. Third, demonstrate that IT can deliver without micromanaging.

In the future, IS is likely to be a service provider in some cases, a vendor manager in others and play no role in still others. Its budgeting processes need to support such diversity. This flexibility will foster IS-business alignment. Now is the time to review and augment existing financial approaches, to better serve the business today and prepare for tomorrow's needs.

IS financial disciplines evolve through five stages



Report toolkit—A selected reference to the tools in this report

Timeline

The five stages of financial disciplines

The three financial elements critical for business alignment

The three financial elements mapped against the five stages of financial discipline

Barriers to IS-business alignment

Sample service catalog of IT services and their prices

Comparison of transparency between a traditional view and an activity-based-costing view

Comparison between traditional budgeting and “beyond budgeting”

Definitions

What is software as a service?

Case studies

Mahindra & Mahindra—IS divides investments into four types

Tata Motors—A central IS budget funds most initiatives, but some are funded by the business

CSR Ltd.—Sensible and simple changes that increased the IS budget

SEAT—How a tool shows staff the budgetary consequences of their actions

Natural Resources Canada—Considering everything, as a project approach has its downside

U.S. Securities and Exchange Commission—A portfolio approach creates transparency and alignment

LoanCo—Gaining flexibility through a companywide projects budget

SKF Group—Objective: To demonstrate that IS can be trusted with money

U.S. Government Accountability Office—Improving transparency and informed decision making around the IS budget

Assessment tools

At what stage is your financial discipline?

Is your transparency right?

Is software as a service appropriate for your organization?

Is a virtuous cycle working for you?

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