

Tactics & Strategies for Reducing IT Budgets During Economic Slowdowns

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What tactics and strategies IT Managers and Executives should employ when faced with the challenge of reducing their IT budget in times of economic slowdowns.

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High-Level Knowledge for Assessing Budget-Reduction Strategies

It is often a challenge for C-level executives to make objective decisions about which areas of their IT budget to cut in times of economic slowdown or recession. Budget-reduction strategies should vary from industry to industry, and from company to company. For example, companies in financial distress, or without good liquidity, should have a completely different strategy than companies that are experiencing consistent growth, or that operate in a growing market and are currently in a healthy financial state. Similarly, a company that has recently merged with another company, and is in the beginning or middle of an integration of their IT operations, has a different budget-reduction strategy than a company that has recently completed a large IT infrastructure upgrade with no need for additional, major IT changes. This Glomark-Governan publication presents tactics and strategies for reducing internal IT budgets.

Traditional TCO Strategies Work Regardless of Economic Swings

Executives must be mindful of the short-term effects of IT cost reductions, and instead, focus their attention on maintaining long-term efficiency. After all, in any organization, IT exists to enable business functions and goals. Any executive can alleviate short-term problems with decisions designed to reduce the overall IT budget, however, an ill-advised decision that may ease financial strains in the short term, can significantly impact the company's ability to grow and exceed its future business goals.

Traditional TCO initiatives, such as "standardization," "outsourcing," and "consolidation," should always be evaluated and considered during economic slowdowns. Other IT improvements strategies, such as "ITIL-based process improvements," require careful consideration, since the long-term impact on IT performance is positive. However, in the short-term, the company must incur a large upfront investment which can often last 1 to 3 years. Glomark-Governan benchmarking research indicates that consolidation, whether it is for datacenters, servers, or any other technology asset, generates immense cost savings in any IT organization. Consolidation is indeed one of the best TCO and budget-reduction strategies that any company can implement, regardless of the economic state. Glomark-Governan benchmarking research findings further indicate that almost every area of an IT budget, such as support, operations, administration, and security, are reduced with IT assets consolidation.

Financial Strategies Implemented to Drive Down IT Budgets

There are some financial initiatives, such as utilizing tax breaks, and accelerated depreciations and amortizations, that can be implemented to improve the short-term health of the company, including the condition of their books and financial image. However, these are often more tactical initiatives that improve the short-term liquidity and cash flow of a company. In general, these initiatives do not provide enough of a substantial impact to reach the necessary level of budget improvements needed to mitigate the financial hardships experienced during an economic slowdown or recession. They must be treated as secondary and complementary financial tactics.

One well-known financial investment that demonstrates this strategic thinking is "leasing vs. buying." Leasing could, in the long run, be more expensive than buying; but, in the short term, leasing always provides a better financial option because there are no upfront costs in purchasing the IT assets.

"If an investment is evaluated solely on the net cumulative cash flow that an asset generates during its life cycle (benefits minus cost during multiple years), interestingly, most of the time, purchasing assets may seem like a better alternative than leasing," says Ruben Melendez, President and CEO of Glomark-Governan. "However, because leasing provides a better payback and better initial cash flow (compared to assets purchased and paid upfront), the IRR is generally better for the leasing option," says Melendez.

One example would be a \$200,000 investment in laptops with a 3 year lifecycle. Leasing provides a 5-month payback, while purchasing the laptops would result in a 15-month payback. In this scenario, the 3 year net cumulative cash benefit of the investment in laptops would be \$363,000 for the lease option, and \$375,000 for the purchase option. Therefore, the net cumulative cash flow (benefits minus costs, minus taxes) for purchasing is slightly better than leasing. Conversely, the IRR for the lease option is 67%, versus 21% for the purchase option, making leasing the best option.

IT Emerging Technologies as Strategies

Glomark-Governan benchmarking research indicates that while some of the new technology initiatives, such as virtualization, online collaboration, and Software as a Service (SaaS), do provide benefits that reduce IT costs, such as support and administration costs, the major advantages of these initiatives are strategic benefits, such as productivity enhancements and revenue-generated benefits for the business areas.

Executives must be mindful though, as any initiative requires an upfront investment. Even with initiatives which have costs spread over time, such as in Outsourcing and SaaS, there is always an investment in time and training, which can be significant.

In the case of software as a service, or SaaS, one must understand that the benefits of moving an existing application to SaaS, versus using SaaS for a new application, provide different types of benefits. The cost savings of SaaS are greater in new applications because a company does not need to make an initial investment in service assets, including hardware to run the software and all the other services needed to implement the new software application. Conversely, if a software application had been previously implemented, transitioning to a SaaS solution may not provide significant cost savings; it may however, depending on the application, provide other business area benefits such as increased productivity, which comes as a result of increased remote user access to the application over an Internet connection.

In the case of desktop or server virtualization, Glomark-Governan benchmarking research findings revealed that the top four economic benefits of IT virtualization include:

- Avoid asset acquisition and renovation costs
- Support cost reduction due to remote user access
- Reduce unproductive costs by establishing systems management rules
- Improved asset utilization as a result of the configuration of virtual devices

C-level executives must also look at the risk of using new and emerging technologies and initiatives. For example, and in the case of SaaS, the cost of technology for risk prevention is lower when compared to SaaS, but the risk of losing critical data is uncertain and therefore higher.

Final Remarks

Budget-cutting initiatives and emerging technology that reduce IT costs can not be selected based on their short-term ability to alleviate financial burdens. C-level executives must prepare business cases with “best,” “most likely,” and “worst” case scenarios to assess the economic benefits (including cost reductions and revenue enablers), fully understand the long-term internal and external costs, and evaluate the risks of investing or not investing in an initiative. Just as with any other investment initiative, budget-cutting initiatives must not only assess how technology and operational costs can be reduced in the short-term, but how business areas and functions will be impacted (positively and negatively) in the long-term.