

CIO spending in 2006

Chief information officers plan to keep operating costs low to spend more on ERP upgrades, servers, and security.

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Chief information officers in the United States say that their plans for 2006 include significantly larger investments in several focused areas. These include upgrading hardware, optimizing systems that serve specific industries, and improving security and reliability—all areas where CIOs can make a strong business case (Exhibit 1). But thanks to cost cutting and productivity improvements, their overall budgets won't rise by much.

Our forecast, based on our survey of 77 US senior IT executives,¹ is that IT budgets will grow by 3 percent on an accrual basis across industries (Exhibit 2). However, this modest increase masks reductions in overall IT operating costs from process improvements (such as streamlining main-frame operations), offshore outsourcing, and new technologies that enable companies to raise their processing capacity without buying more hardware. These savings will allow capital expenses to increase by 13 percent.

A critical piece of this spending is a new wave of enterprise-resource-planning enhancements: 47 percent of the respondents say they are budgeting substantial investments in ERP for the coming year. The top priority is sector-specific enhancements to basic ERP platforms. Most large companies have already implemented the basic elements

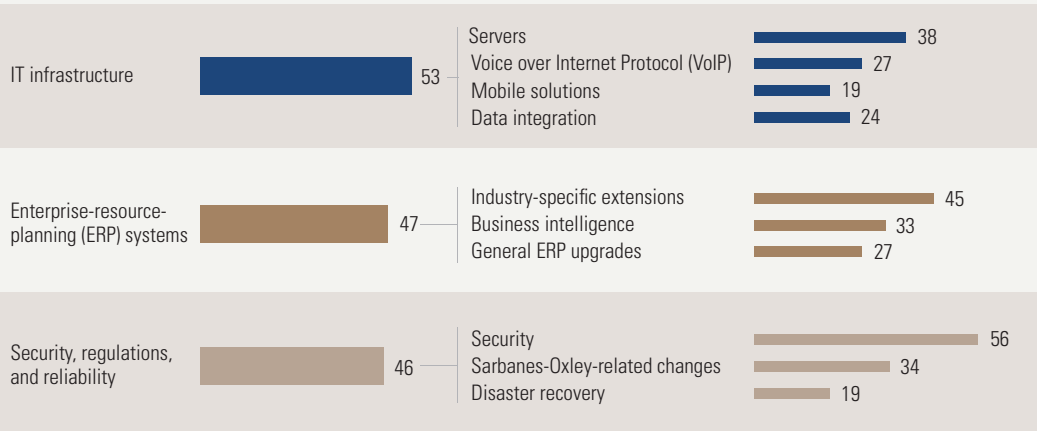
EXHIBIT 1

The CIO shopping list

% of respondents¹

Key categories for investment

Specific areas of investment within category



¹Figures do not sum to 100%, because respondents were allowed to choose more than 1 answer.

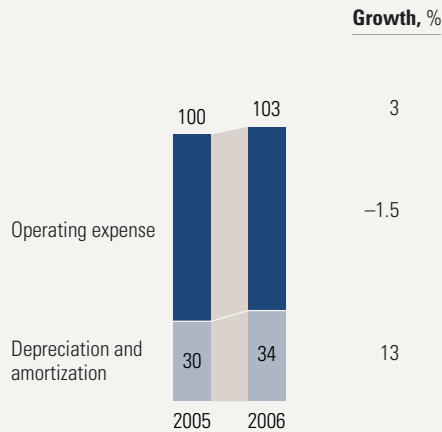
Source: 2005 McKinsey survey of 77 US senior IT executives

¹During the summer of 2005, McKinsey surveyed 77 senior IT executives from US companies with more than \$1 billion in revenue. Participants were selected from various industries, with the aim of mirroring the US GDP and so capturing trends in the overall economy.

EXHIBIT 2

A modest increase

Index: 2005 total accrual budget = 100

Projected IT budget growth on an accrual basis**Projected IT budget growth on a cash basis**

Source: Interviews; 2005 McKinsey survey of 77 US senior IT executives

of ERP systems to manage materials and core operating processes and to generate financial metrics. Now many CIOs report that they are building extensions to these systems to improve the productivity of sector-specific operating processes and to address competitive issues in their industries. Retailers are investing in ERP extensions that help managers maximize sales by deciding when and how much to mark down prices.

CIOs also plan to invest more in business intelligence tools, including applications that extract data from ERP systems and allow users to analyze customer or market trends in finer detail. And they are enhancing the finance and accounting modules of their ERP systems to comply with governance regulations such as Sarbanes-Oxley.

Hardware upgrades are another high priority: more than half of the survey respondents say that such expenditures are in the cards for 2006. Companies are replacing servers bought during the late 1990s—often with fewer or less expensive servers, thanks to consolidation and virtualization (the ability to run a number of operating systems on one computer or to distribute processes across multiple machines). They also want to replace their circuit-based telecom infrastructure with Voice over Internet Protocol (VoIP) telephony to combine their voice and data networks and so reduce costs. Also on the list is building up mobile-networking capabilities to handle more data, more devices, and more applications so that mobile workers can be more productive. Also high on wish lists are systems (typically, in application servers or middleware suites) that help deliver data to the right place, at the right time.

Finally, CIOs plan to invest in disaster recovery and availability technologies to comply with regulations requiring that financial and operational data be protected and maintained for longer periods. Security too still looms large in the thinking of CIOs: in particular, the increasing threat of intrusions at firewalls and further into networks is prompting them to add monitoring and prevention systems as well as remediation technologies, which help IT departments clean up and repair systems after intrusions have taken place.

During 2006 and beyond, we expect CIOs to keep up the pressure to wrest cost savings

from IT operations, not least because those savings represent a major source of funding for new investments. **MoIT**

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