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# Building efficient IT organizations: Insights from our benchmarks

A focus on five high-level capabilities may help IT organizations reduce costs, improve productivity, and successfully pursue digital innovation.

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Not so long ago, the mandate for many CIOs was relatively simple: keep IT spending in check while maintaining basic service levels for the business units. As more and more companies begin to explore digitization, however, the CIO's job has grown more complex. On top of the usual concerns about maintaining efficient IT operations, CIOs must now determine how best to support emerging digital initiatives, the integration of new technologies, and the creation of more efficient processes. CIOs face two core questions, then: Which improvement initiatives can help advance the company's digital programs? And when it comes to increasing the efficiency of IT organizations, what really works?

We set out to answer these questions. There has been anecdotal evidence but little data-

backed evidence on what creates the greatest efficiencies in IT organizations. So we conducted a benchmarking exercise. Over a five-year period between 2010 and 2014, we collected data from 164 banks and 97 telecommunications companies worldwide. Companies in these industries are heavy users of technology. Increasingly, they have faced significant competitive pressures to digitize products, processes, and customer experiences.

We assessed these companies' spending on IT as well as the level of their IT-management capabilities.<sup>1</sup> We wanted to know which best practices the exemplar companies—those that were most efficient—were using to manage information technologies, and how much these activities were costing them, compared

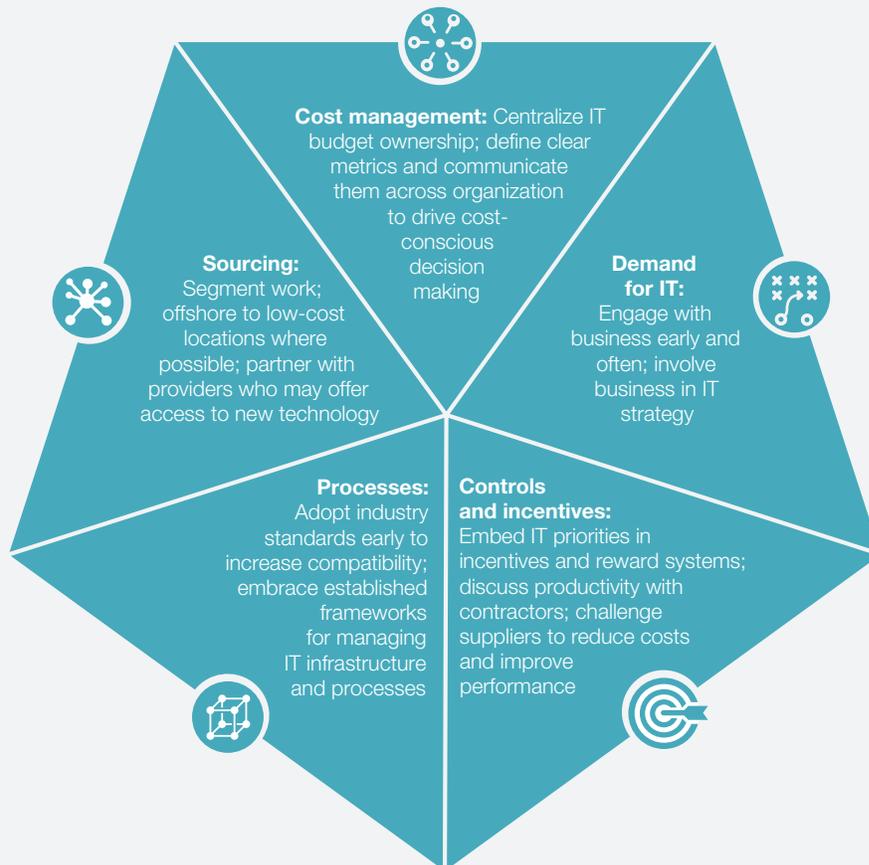
with those companies that were not as efficient. Our breakdown indicated that the highly efficient performers focused primarily on just five enabling capabilities (exhibit):

- Centralize cost management and identify key performance indicators.
- Manage business units' or functions' demand for IT based on business value.
- Control productivity and create incentives that promote it.

- Standardize, simplify, and automate processes.
- Optimize sourcing.

In part because of their strong focus on these five capabilities, the highly efficient companies in our benchmark were able to optimize their IT spending and divert funds to burgeoning digital initiatives—projects designed to address day-to-day concerns relating to security, regulation, “technical debt,” and systems maintenance, as well as more innovative projects aimed at reshaping the customer experience, reducing complexity, or supporting new lines of business.

**Exhibit**      **Implementing best practices in five areas may help increase IT efficiency.**



Source: McKinsey analysis

We believe that if less efficient companies can similarly focus on what works, they, too, can improve their IT operations and free up resources for digital initiatives. Over time, they may be able to establish self-funding mechanisms for digital innovation and, ultimately, self-sustaining IT operations. Although our analysis focused on banks and telecommunications providers, we believe the findings may be relevant to companies in almost any industry where reliance on complex technology systems is high, digital innovation is critical to success, and CIOs are seeking the most bang for their IT buck.

### **1. Centralize cost management and identify key performance indicators**

Every company recognizes the need to be strict about costs—particularly when it comes to vetting, sourcing, and implementing the wide range of technologies required to conduct business in the digital era. As most CIOs know, this can be a never-ending task. And not every senior leadership team takes the time to define clear metrics or mechanisms for ensuring that IT costs are being regularly reviewed and controlled.

The highly efficient companies in our research tend to do two things reliably: they centralize their cost-management processes, and they identify and broadly communicate the most critical measures of performance. Rather than cede control of IT spending to individual business units, they assure transparency by convening a central governing body that reviews all IT investment requests, approves or rejects them, and prioritizes them. Such reviews are not just conducted annually; they are undertaken on a rolling basis—at least quarterly—to make portfolio, funding, and resource-prioritization decisions. In this way, IT leaders and business-unit leaders from all parts of the company can gain clear insight into the costs required to meet their individual (and collective) business requirements. Conflicts of interest are nipped in the bud.

Additionally, in the highly efficient companies, IT leaders work with business-unit leaders to define critical performance metrics, such as cost of IT per user, transaction, or interaction. These metrics are communicated throughout the company, so that performance expectations are shared and transparent. For instance, a company could mandate that full-time employees in the IT organization meet threshold productivity standards (based on the defined metrics) to control IT costs.

### **2. Manage demand based on business value**

Related to the need for strict cost management is the need for IT and business units to have a clear and shared understanding of business-unit and functional priorities, ranked according to their contribution to business success. In many of the less efficient companies in our research, the IT strategy is formulated with only limited or periodic input from the business units or functions. This prevents business leaders from understanding how best to work with IT, what kinds of resources are available, and how to gain the most value from the relationship. By contrast, the highly efficient IT organizations in our benchmark constantly and actively engage with the business units and functional leaders on how IT can improve business processes or customer experiences. IT strategy is formulated in close cooperation with the business units through formal governance structures and processes, and with adequate representation from critical IT and business stakeholders.

In the highly efficient companies, there are clear incentives for the business units to monitor and continually improve their demands for IT resources. Some of the companies in our benchmark, for instance, employ usage-based pricing for IT services, rather than fixed prices. That way, the business units can pay less in chargebacks when they consume less than the amount budgeted for IT services.

### 3. Control productivity and create incentives that promote it

To be truly productive, companies must control for a range of ever-changing factors—a churn of people, technologies, and market demand. The highly efficient companies in our research have found ways to account for the inevitable shifting of resources and staffing (in-house and external contractors) that occurs in most IT organizations. They establish clear incentives and reward programs that motivate good behaviors from IT staffers and business-unit partners alike. They maintain a centralized database of resources. This database includes skill sets represented in the IT organization, individuals' experience with certain types of technologies or within certain business domains, and other useful information that can aid in decision making. The information is updated regularly.

The highly efficient organizations in our benchmark also boast flat structures; they use collaboration technologies rather than managerial hierarchies to disseminate information. They tend to increase the span of control given to IT managers; on average, more than 15 people report to each IT manager at these companies, compared with between 5 and 10 people per IT manager at less efficient companies. Within these flat organizations, managers focus on coaching their teams but also strive to keep themselves up-to-date as technologists. Furthermore, the highly efficient companies view their IT suppliers as important strategic partners. They frequently engage their contractors in productivity discussions. They track the length of agreements with contractors and strive to convert high-tenure contractors to internal staff.

### 4. Standardize, simplify, and automate processes

In response to the widespread digitization of products and processes and end users'

growing expectations for always-on data and services, IT organizations must look for ways to move faster. Release cycles are getting shorter, which puts an even greater premium on IT efficiency and precision execution. Many of the highly efficient companies in our benchmark are responding by deploying agile-development methodologies and continual-delivery systems. Under these approaches, IT and business leaders jointly develop, test, and learn from frequent software iterations. Decisions must be made quickly—a marked change from the use of the traditional waterfall approach to development, which can get mired down in bureaucracy.

To enable agile operations, the highly efficient performers rely, to a large degree, on best practices in standardization, simplification, and automation. They employ repeatable processes for making changes to products and systems, always anticipating future needs. In some cases, product owners from agile teams directly lead these changes. But in cases where system changes would affect multiple agile product teams or process steps, companies have created a central “change-management office,” with representation from across the IT organization and the business units. This governing body can review and approve change requests quickly, thereby establishing a strong business case for go/no-go decisions about what to simplify and how to sequence any changes.

The less efficient companies in our research tend to adopt industry-standard technologies only when there is competitive push to do so. The highly efficient companies, by contrast, actively participate in standards-making organizations and bodies, and they incorporate industry standards within their IT architectures as early as possible. In these ways, they foster compatibility with external partners' systems and can avoid the need to make significant

changes as existing systems age. Again, in agile work environments, where delivery times are expected to ramp up significantly, such adherence to standards becomes even more critical.

Finally, the highly efficient companies in our benchmark were likelier than the other companies to have deployed virtualization across servers in all business units and functions. As companies collect more customer information and need to transmit it in real time across applications, they require more storage and computational power. But rather than add more components to an already complex system, the highly efficient companies are exploring cloud technologies and automation—for instance, automating server deployments and load balancing. These changes have given companies much greater flexibility in meeting demands for computing power and storage capacity while still handling high-volume, highly variable workloads.

## 5. Optimize sourcing

Companies' relationships with IT suppliers are critical for ensuring efficient, reliable operations. These relationships can be difficult to maintain, however, when expectations on both sides are miscommunicated. IT buyers often struggle to understand how to set realistic objectives and incentives; how to balance multiple priorities relating to cost, efficiency, quality, and innovation; and how to structure governance arrangements to benefit both sides. Meanwhile, IT providers wrestle with how best to meet a range of customer expectations, prioritize objectives and resources to help customers meet their individual needs, and create next-generation improvements and innovations for customers, rather than just carrying out immediate tasks.

The highly efficient companies in our benchmark view sourcing relationships differently from the less efficient companies. They believe the sourcing relationships give them opportunities to learn about new technologies and frameworks

that are relevant to the business or their industry. They treat IT suppliers as partners, rather than mere providers. To that end, they attempt to develop a shared understanding of outcomes—for instance, taking the time to consult with key internal stakeholders as well as IT suppliers about desired goals and “beyond cost” opportunities. They focus on the long-term opportunities presented by the sourcing relationship—for instance, the ability to partner with IT suppliers on innovative projects—and devise win-win contract mechanisms. As we mentioned earlier, the highly efficient companies encourage the conversion of high-tenure contractors to full-time internal staff, and they establish incentives and talent strategies to make this path possible.



To capture value from the five core capabilities highlighted by our benchmarking work, companies must explore an integrated set of operating-model changes, not just isolated initiatives to close individual gaps. True breakthrough efficiencies typically occur only with a combination of best practices in all five areas. For instance, strict cost controls, effective sourcing approaches, and IT demand-management practices have made it less expensive for some highly efficient IT organizations in our benchmark to run their infrastructures. They routinely inform internal customers about the cost to meet their demands for IT service. They implement chargebacks in ways that create incentives for business units to clarify requirements, and they negotiate contracts with vendors that align interests and assure joint commitment to productivity-driving innovations. They have improved their time to market and the quality of their decision making, while devising clear road maps to deliver new business and IT capabilities. What's more, they are boosting their odds of success with digital transformations that may be critical to business survival. Indeed, they are realizing a substantial efficiency dividend and then

reinvesting that in their most critical priorities. We believe that many players operating at lower efficiency levels can capture this same prize by focusing their attention on the right levers. ■

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<sup>1</sup> The research was conducted on a rolling basis. We used a maturity index based on 250 predetermined best and worst practices in IT management. The companies in our data set were ranked as either “efficient” or “not efficient” based on their IT spending and the presence (or lack) of these specific capabilities in their IT organizations.

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