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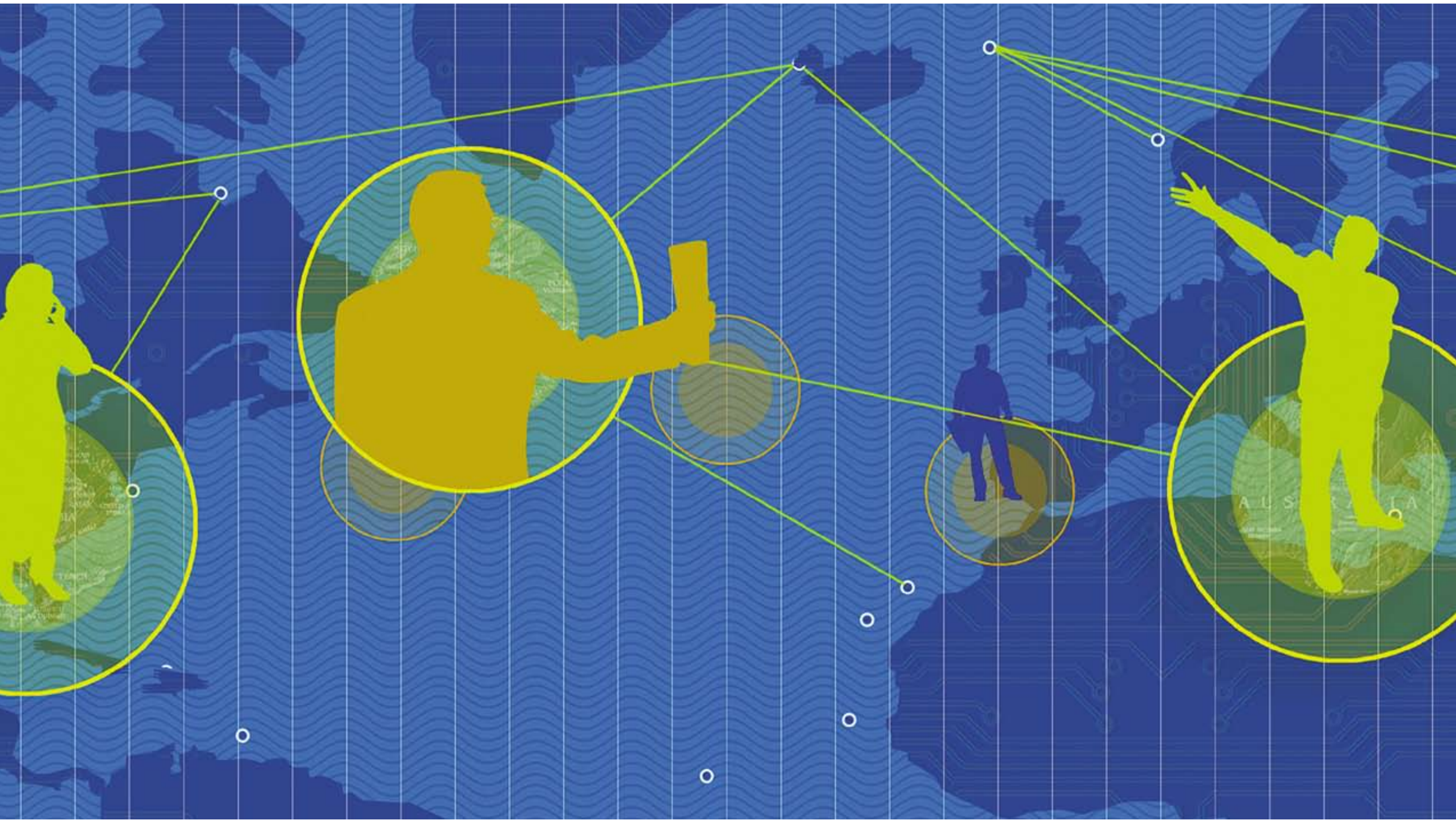


Time to raise the CIO's game

In the 'new normal,' successful CIOs will search for value through experimentation with customers and partners.

Michael Chui, Pär Edin, and James Manyika

As economies around the world emerge from the current downturn, many executives understand that what follows probably won't be just another turn of the business cycle. This new period will see a restructuring of the economic order. Some are calling it the "new normal,"[1] marked by persistent uncertainty, tighter credit, lower consumer spending, and greater government involvement in business.

For executives who run major IT organizations, the implications are clear: they will have to make the IT function dramatically more productive, use IT more effectively to meet larger company goals, and embrace disruptive technologies that will shape the new economic terrain. Drawing upon our experience with clients, recent McKinsey surveys of executives, and a range of interviews with experts, we have analyzed what the new normal means for CIOs in Europe. While some of the forces impinging on them are specific to that region, many of our findings are applicable to IT leaders elsewhere as well.

First and foremost, CIOs will have to overcome hurdles that have limited IT's performance in recent years:

- They must promote a much closer alignment between IT and the business units by embracing new organizational models that call for joint decision making. IT leaders will need better business skills, not just technical know-how.

- IT productivity efforts must leap beyond cost cutting at the margins. CIOs will have to make fundamental changes in the way IT operates

[1] Ian Davis, "The new normal," mckinseyquarterly.com, March 2009.

Takeaways

The 'new normal' means a much tougher environment for CIOs

The IT organization will need to step up its productivity significantly

CIOs will be called on to ensure operating improvements across the entire company

Companies need to embrace disruptive technologies, and CIOs must lead the charge

Collaboration between business and IT needs to get real

and campaign for technological improvements that will transform cost structures and operating models throughout the enterprise.

- IT leaders must join with their business counterparts to seek out and implement technology-based innovations that will give companies long-term competitive advantages in a tougher economic climate.

In the past, IT performed satisfactorily if it made marginal progress in these areas. In the new normal, it must truly excel in all of them—the performance bar is higher, and the expectation that IT should contribute to corporate success is more insistent.

Europe's challenging landscape

While recent data suggest that the economic downturn may be bottoming out, rapid, robust recovery may prove elusive. Fewer than half of European executives—similar to their counterparts in other developed markets—expect their companies to perform better in 2009 than 2008: 38 percent expect profits to increase in 2009, compared with 42 percent in North America and 44 percent in Asia-Pacific. In contrast, executives in developing markets (including China and India) are more optimistic, as 53 percent expect profits to increase in 2009.[2]

In this environment, overall cost pressures on companies will remain unrelenting. IT organizations will therefore have to do their part in reducing budgets through productivity savings, as well as self-funding investments in everything from new servers to improved IT architectures. In fact, Europe's IT organizations appear to face higher cost pressures than their counterparts in other regions do: in another survey, 82 percent of the respondents from European companies expected flat or falling IT budgets for operating expenses in 2009, compared with 68 percent in North America, 80 percent in the Asia–Pacific region, and 62 percent in developing markets.[3]

IT will also be required to help improve both the efficiency and the effectiveness of business operations (such as payroll and transactions) throughout the enterprise—and dramatically. Our survey of IT and business executives found that for European and non-European IT organizations alike, making business processes more efficient is the top priority and making them more effective a close second. Banks, for example, suffer from lower leverage and thus lower revenues in the aftermath of the crisis and must reduce operating costs substantially. Some institutions are therefore using powerful new cross-border IT platforms to gain efficiencies and provide more and better banking products through IT-backed self-service.

Despite the pressures, companies can't lose sight of the opportunities for the kind of transformation that would help them establish market leadership in the new normal. Our research has shown that 47 percent of market-leading global IT companies before the 2000–03 recession didn't hold onto their leadership positions after it.[4] In a positive sign, 31 percent of European executives—when asked to list their top priorities—included the development of new products and services in response to changing consumption patterns, and 22 percent included the search for new markets in response to changes resulting from the economic crisis.[5]

Hurdles for the CIO

While the new normal creates a novel set of challenges for CIOs, the problems that made IT less productive before the downturn haven't disappeared. In some cases, their impact has deepened as a result of aggressive cost cutting and unresolved structural issues. At many companies, the IT

[2] For more on this survey, see "The crisis—one year on: McKinsey Global Economic Conditions Survey results, September 2009," mckinseyquarterly.com, September 2009. The survey includes 1,677 responses from executives around the world, representing the full range of regions, industries, and functional specialties. As used in this article, "Asia-Pacific" excludes China and India, which are included in the "developing markets" category. See Exhibit 2 for a definition of each category.

[3] From a proprietary McKinsey business technology strategy survey, Q4 2008 (with 548 respondents around the world), targeting business and IT executives in equal proportions. Of the IT executives, about half were CIOs or chief technology officers.

[4] From a proprietary McKinsey analysis of semiconductor, software, hardware, and IT services companies. Leaders were defined as being in the top 25 percent of their segments by market-to-book ratio and ROIC. Compares pre-recession rankings in years 1998–99 and post-recession rankings in years 2004–06.

[5] See "The crisis—one year on: McKinsey Global Economic Conditions Survey results, September 2009," mckinseyquarterly.com, September 2009.

function and the business side fail to coordinate their activities sufficiently, which makes organizations less efficient and effective and impedes the collaborative effort needed to adopt and apply game-changing technologies.

Responding to our survey, 71 percent of European IT and business executives said that IT must be tightly integrated with business strategy, but only 27 percent thought that this actually happened at their companies. In addition, fewer CIOs in Europe than in other regions report to the CEO (Exhibit 1): only 31 percent in Europe, versus 56 percent in North America, for example.[6] This finding suggests that European companies continue to think IT leaders should focus on back-office operations rather than strategy and growth efforts.

Many of the European IT executives surveyed believe that there is room to improve the effectiveness of traditional IT activities, such as managing the IT infrastructure (38 percent), strategic sourcing (68 percent), and IT performance (60 percent). Business executives believe that IT could support their units more effectively by forging better partnerships to reconceive and upgrade existing processes and systems (81 percent) and by innovating with new technology-supported capabilities (77 percent).

In an increasingly tough operating environment, structural factors make the tasks facing Europe's CIOs even more difficult than those of their counterparts elsewhere. European markets remain fragmented by language and culture, and their laws and regulations still differ substantially, despite EU standardization efforts. What's more, many European companies have long used M&A to enter new markets, so their operations are larded with complex legacy systems and governance issues. One major telco, for example, operates in almost 20 European countries, with separate IT platforms and data centers that prevent it from achieving economies of scale.

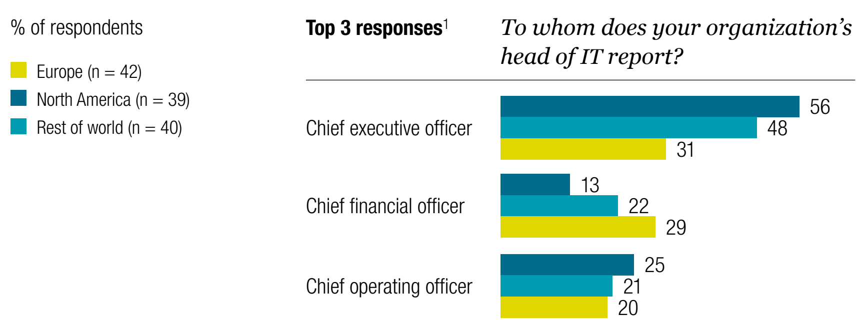
In pan-European companies, country-level CIOs tend to make IT decisions individually, impeding efforts to improve company-wide systems. Government regulations may impose new demands on IT, such as stringent requirements for safeguarding personally identifiable information. Labor laws, which tend to be less flexible in Europe than in some other areas, make performance-based incentives and IT projects harder to manage.

[6] From a proprietary McKinsey business technology strategy survey, Q2 2007. Additional 2009 surveys in individual sectors confirm that these trends have continued.

Exhibit 1

The weakest link: CIO to CEO

Heads of IT in Europe are less likely to report to CEOs than IT chiefs in other regions.



[1]Other responses included head of shared services and head of sales.
Source: Q4 2008 McKinsey business technology strategy survey

Partly because IT-enabled staff reductions would have been difficult to realize, one European pharma company chose to continue operating some parts of its finance operation manually rather than invest in IT systems.

Seventy-four percent of the European IT and business executives we surveyed believe that their companies are very or extremely susceptible to disruptions stemming from IT (Exhibit 2)—a percentage higher than those in other regions—yet only 48 percent believe that their companies are very or extremely well-prepared for them. As for IT's ability to transform the competitive landscape, some companies have yet to recognize the role of technology in helping them succeed: a third of the European IT and business executives we surveyed didn't view IT as being among the top three levers for creating competitive advantage.

Succeeding in the new normal

To meet the new demands, CIOs should start with efforts to tear down the remaining walls between IT and the business in order to focus on ambitious targets such as upgrading IT operations and enabling IT to improve corporate performance. Demonstrating early successes helps CIOs earn the right to address more far-reaching goals by leading the company-wide adoption of new technologies, such as Web 2.0. A flexible and focused IT organization will be better positioned to enable top-line growth and more open to innovative technologies and the new business models they imply.

Aligning IT with the business

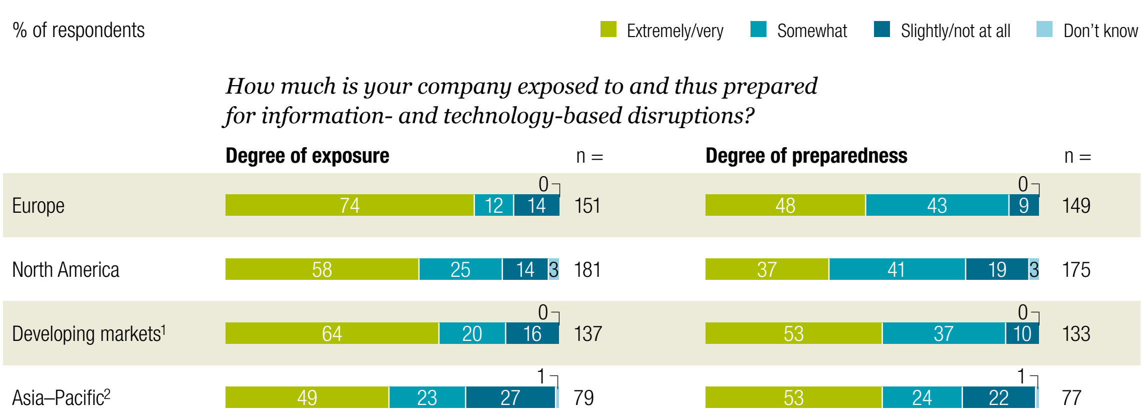
The imperfect relationship between business managers and their IT counterparts is a long-standing problem. But the new normal brings more urgency to finding a solution—one that will demand better governance, as well a broader range of management skills among IT executives. Step number one should be establishing a joint-governance model for IT and the business to facilitate better decisions and alignment around priorities.

These governance practices should, for instance, promote joint decision making, which will give IT better insights into the needs of the business

Exhibit 2

Unprepared

Respondents perceive a gap between the exposure of their companies' IT-based disruptions and the preparedness of those companies to deal with them.



[1]China, India, Latin America, and other Asian countries not included in Asia–Pacific.
[2]Australia, Hong Kong, Japan, New Zealand, Philippines, Singapore, South Korea, and Taiwan.

Source: Q4 2008 McKinsey business technology strategy survey and help business managers understand IT's capabilities and potential. Here's one illustration of why this is so important: in the new economic landscape, customers will wield more power than ever before, and IT systems can provide the interfaces (such as online self-service) for reaching them. It's therefore essential for IT managers, at all levels, to understand the needs of the business's customers—not just those of IT's internal customers—and to think creatively about how to help the business meet them.

Joint participation in decision making will help IT to anticipate the evolving needs of the businesses it supports and to deploy its resources accordingly. At one utility company, for example, the trading function's IT team provides 24-hour support. As a result of this close collaboration, the team has significantly shortened the time required to develop features for new trading instruments, and trades therefore adjust more rapidly to shifting market conditions.

When a company chooses its IT leadership, it must recognize that technical skills alone are no longer sufficient. To be valuable partners for business unit leaders, their IT counterparts must not only be well-grounded in strategic planning, finance, and executive-level communication but also have deep industry knowledge and experience. Recruiting remains critical to filling talent gaps, but companies can develop capabilities across functional areas by rotating IT leaders through business roles and business leaders through IT roles.

Closing performance gaps

Since the downturn began, many CIOs have scrambled to control costs by delaying investments where possible and pushing service providers to cut prices. Some CEOs are raising cash through the sale and leaseback of assets such as data centers. But as competition intensifies, a more fundamental restructuring of IT operations will be in order.

Certain companies are rethinking their current approaches to procurement in hopes of replacing the current model of capital spending on infrastructure with a more flexible approach to operating expenditures. Cloud computing and software-as-a-service, for example, allow companies to purchase computing power and application services that scale with demand and thus to avoid large capital outlays on infrastructure capacity to meet peak loads. The cash savings from such efforts can be critical for self-funding additional IT investments: shifts in certain basic IT operations, for instance, could finance a streamlined IT architecture that will improve long-term productivity (see sidebar, "Further reading on IT management").

IT can achieve even bigger productivity gains—up to ten times bigger—by enabling major improvements in the way business units work, thus radically transforming their cost structures and service to customers. Financial institutions, for instance, can generate savings by extending high-performance IT systems and platforms across regions and borders. As much as 90 percent of the synergies from banking mergers flow from reduced operating costs, which in turn are related directly to the consolidation and standardization of IT processes. After launching a common cross-border IT platform, for example, one European bank cut its operating costs, especially those incurred running the banks it had acquired, far below those of its peers. In one acquisition, it achieved 95 percent of the expected total synergy savings in the first year, providing ample funding for further investments and new acquisitions.

Technologies for collaboration enabled by IT—including the now familiar Web 2.0 tools, such as wikis, blogs, and social networking, as well as others that facilitate live communication and the sharing of documents—can help make knowledge workers more productive. In a recent survey,

Further reading on IT management

McKinsey has published perspectives on managing IT in *McKinsey Quarterly* and *McKinsey on Business Technology*. A selection of recent articles, available at mckinseyquarterly.com, appears below.

James M. Kaplan, Roger P. Roberts, and Johnson Sikes, "Managing IT in a downturn: Beyond cost cutting," *McKinsey on Business Technology*, Number 13, Fall 2008.

James M. Kaplan and Johnson Sikes, "Managing IT spending," mckinseyquarterly.com, December 2008.

Stefan Spang, "Five trends that will shape business technology in 2009," *McKinsey on Business Technology*, Number 15, Spring 2009.

Michael Bloch and Andres Hoyos-Gomez, "How CIOs should think about business value," *McKinsey on Business Technology*, Number 15, Spring 2009.

Driek Desmet and Tor Mesøy, "Memo to the CEO: Why we need an annual report for technology," *McKinsey on Business Technology*, Number 15, Spring 2009.

Jeffrey Hughes and James Kaplan, "Where IT infrastructure and business strategy meet," *McKinsey on Business Technology*, Number 16, Summer 2009.

most respondents reported that they had achieved measurable business benefits from their use of collaborative technologies,[7] but work remains before companies can realize their full benefit.[8]

Enabling transformative moves

To meet the demands of the new normal, companies must adopt technology-based innovations in products, services, processes, and business models. They'll need to develop the ability to identify transformative opportunities, along with a heightened awareness of the competition's possible disruptive maneuvers. CIOs and business executives can improve their competitive intelligence by participating actively in technology forums, networking with their partners in academia and start-ups, and assuming a perspective that takes them beyond their comfort zone in thinking about business sectors and geographical markets. They must also foster and reward experimentation by role modeling the new mind-set, clearly communicating the new objectives, investing to give executives and staffers alike higher-level skills, and creating new incentives.

Some CIOs in Europe are already navigating these disruptive currents. A major European utility revamped its business model by installing interactive "smart" meters across its entire customer base to provide a flow of detailed data on energy usage and customer behavior. The company used this information to reduce its losses from unbilled delivery, saving an estimated €600 million annually on a €2 billion investment. With a better reading of the needs of customers, the utility could also offer new pricing models (for instance, hourly or weekend rates) to attract and retain them in a deregulated energy market.

A major European fashion retailer uses real-time information to achieve a cycle time of one to two weeks from initial design to final sale of new clothing. Its designers use real-time data from retail sales to gain insights into which fabrics, cuts, and colors are in highest demand and use that information to design new clothing lines or modify existing ones. The retailer also exploits real-time information gained by testing products in representative stores to determine production quantities and reallocate slow-moving stock to locations where demand is stronger. In this way, the company limits its markdowns to half the industry average.

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The traditional IT mind-set aims to capture the value of technology through top-down planning, formal structures, and clearly defined processes. In the new normal, the mind-set for success will emphasize a bottom-up search for value through experimentation with customers and partners. Winning CIOs in this new era will view uncertainty and an extremely demanding operating environment as opportunities to challenge prevailing assumptions about the role of IT.

[7] See "How companies are benefiting from Web 2.0: McKinsey Global Survey Results," mckinseyquarterly.com, September 2009.

[8] Michael Chui, Andy Miller, and Roger P. Roberts, "Six ways to make Web 2.0 work," mckinseyquarterly.com, February 2009.

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Michael Chui (Michael_Chui@McKinsey.com) is a senior expert in McKinsey's San Francisco office; **James Manyika** (James_Manyika@McKinsey.com) is a senior partner in the San Francisco office; and **Pär Edin** (Par_Edin@McKinsey.com) is a senior partner in the Stockholm office.