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Strategic Cost Optimization: Driving Business Innovation While Reducing IT Costs

CIOs embrace strategic cost optimization initiatives by striking a balance between IT spend and investments in business innovation.



KEEP CHALLENGING™



Executive Summary

Faced with ongoing business uncertainty and never-ending pressure to optimize IT spend, CIOs are shifting away from pure cost reduction programs and embracing more strategic cost-saving initiatives. Strategic cost optimization techniques prepare organizations for growth by striking the right balance between reduced IT spend as a percentage of revenue and increased investments in business innovation and IT improvement initiatives. Thus, many CIOs are turning to strategic IT cost optimization (ITCO) programs that support a business mandate to simultaneously innovate and build long-term competitive advantage while reducing technology-related costs.

This white paper weighs the benefits and downsides of short-term cost reduction vs. strategic cost optimization programs and offers a four-level framework for prioritizing initiatives that enable IT to better support the business, both today and for the future. It provides a framework that can help CIOs prioritize cost optimization initiatives by considering not only the potential cost savings, but also other benefits, such as time requirements, degree of organizational and technical risk, impact on customers and investment required.



Short-term Cost Reduction vs. Strategic IT Cost Optimization

Decision-makers often resort to cost-cutting measures in response to business pressures to reduce IT spend. However, by focusing on short-term cost-cutting within organizational siloes and without the context of the business strategy and technology roadmap, these initiatives often result in higher IT costs in the long term and, in some cases, are abandoned altogether. Figure 1 compares the outcomes of short-term cost-cutting initiatives with a more forward-looking strategic cost optimization program focused on organizational health.

Strategic IT optimization initiatives require upfront investments and are conducted within the context of the business and IT strategy. While a long-term perspective on cost-cutting is important, short-term reductions are achievable through the identification of quick wins that are less disruptive to the business (e.g., software license reductions, application consolidation and retiring applications).

As time progresses, organizations begin to realize the benefits of these investments and cost-saving initiatives. The savings that result can then be directed to bottom-line spend reductions, or some portion can be reinvested in subsequent optimization initiatives, depending on the current and future strategic needs of the business.

Large upfront investments that are needed to drive lower unit costs are often counterproductive due to:

- Unpredictable business requirements and IT demands (e.g., fluctuating economic, sector and industry conditions).

Cost Reduction vs. Cost Optimization

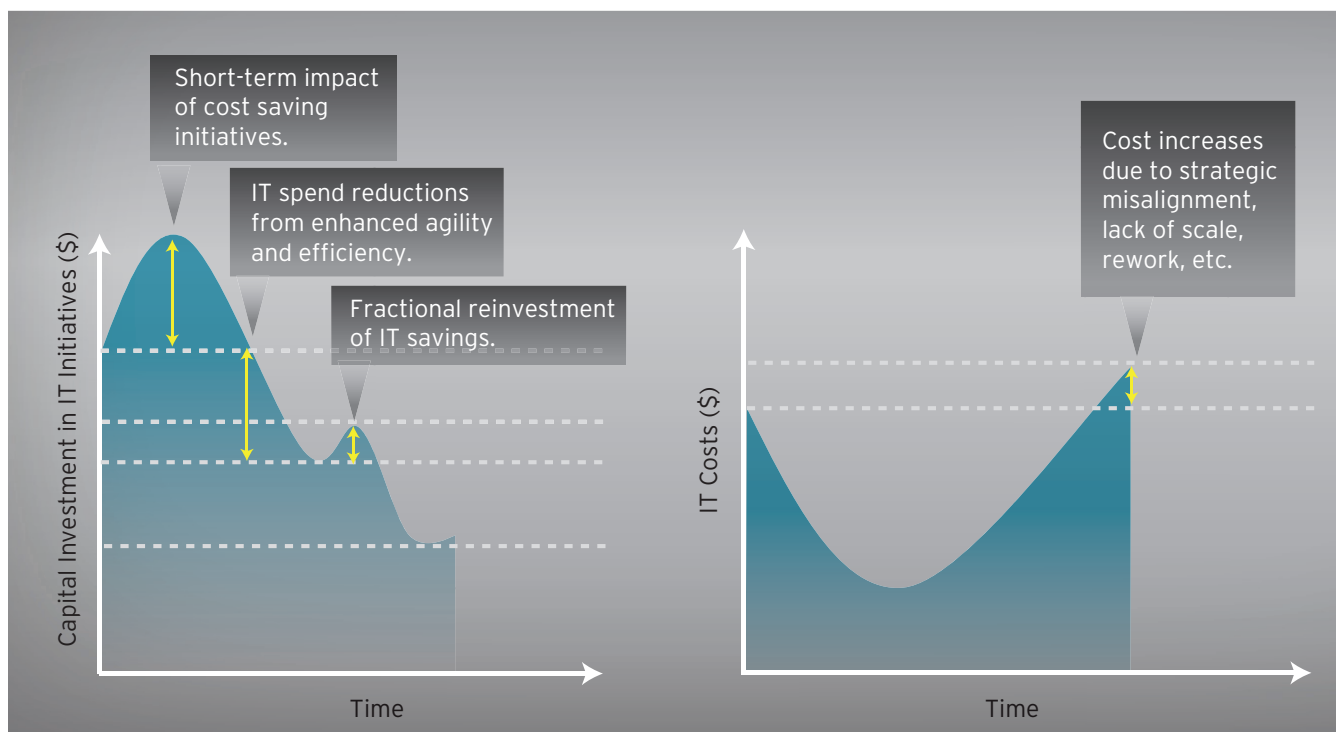


Figure 1

- Potential business exit/divestiture.
- Short-term opportunities or projects that are inconsistent with the long-term business direction.
- Rapid new business/growth opportunities that require frequent IT changes and expensive scaling.

Software as a service (SaaS) and other services delivered via the cloud may appear to be more expensive initially, but they may often provide improved long-term returns. This is because of the operational and financial flexibility that these initiatives afford, such as consumption-based pricing that variablizes cost outlays.

Thus, a strategic IT cost optimization program is not a one-time initiative. Instead, it is a continuous improvement exercise for CIOs seeking to optimize IT spend and deliver a sustainable business advantage. However, CIOs can no longer concentrate resources and investments on cost reduction efforts alone; they must maintain an appropriate balance between meeting savings targets and supporting necessary innovation and process improvements that future-proof the business.

Four Levels of Strategic Cost Optimization

Figure 2 illustrates how an organization can transform its cost optimization efforts from tactical to strategic and realize maximum value over a specific period of time. Our framework helps CIOs and other decision-makers weigh the risk-reward tradeoffs of all possible initiatives before implementing them.

A Framework for Strategic Cost Optimization

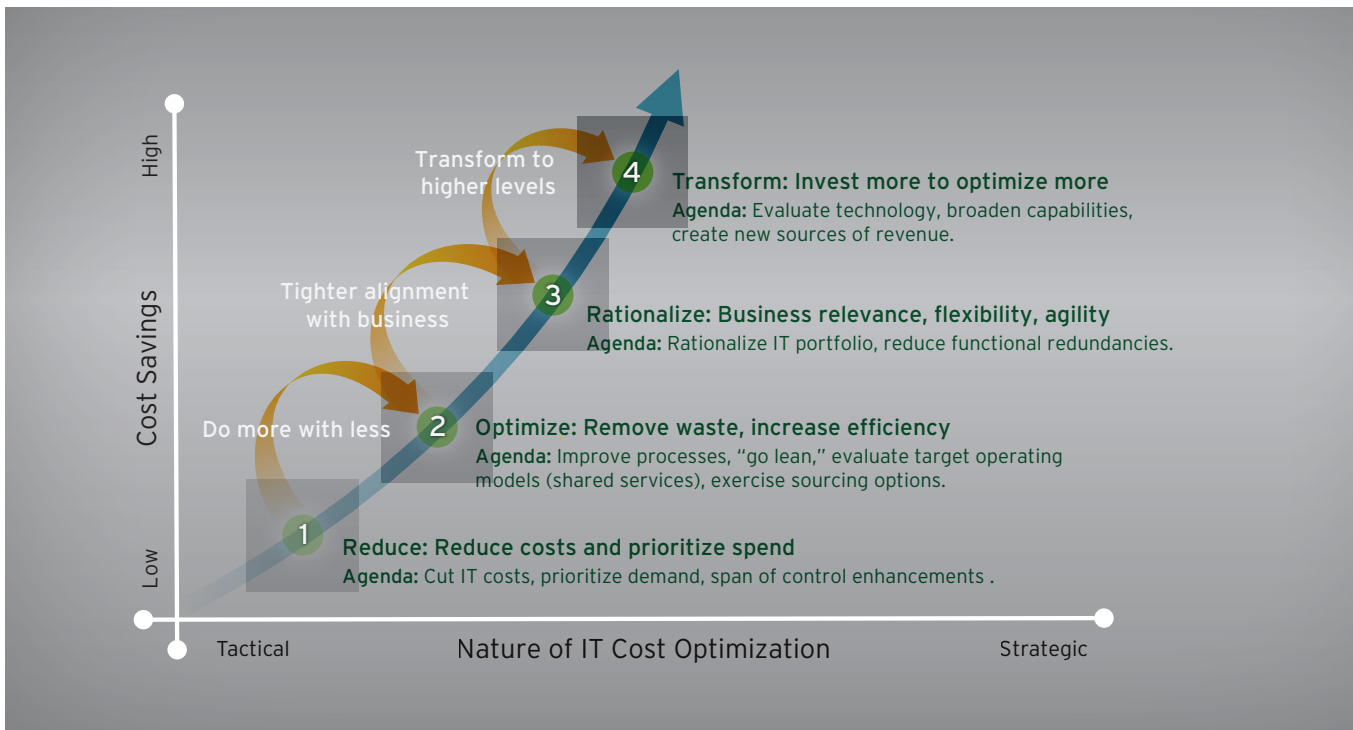


Figure 2

Here is a closer look at each level within the strategic cost optimization framework:

- **Level 1 (Reduce):** Cut costs and prioritize spend.

Companies tend to prioritize cost optimization initiatives by simply considering short-term cash savings. While cash savings are important, prioritizing cost optimization initiatives with only short-term goals in mind can cause unanticipated problems. Decision-makers must consider the degree of organizational and technical risk, as well as the impact of such myopic thinking on consumers of IT services.

- **Level 2 (Optimize):** Remove waste and increase efficiency.

Cost-cutting can have unforeseen negative consequences. The focus should be on eliminating excess waste while increasing the efficiency of current systems. Speed-to-market, quality and utilization have become exceedingly important. Suitable metrics to measure performance should be implemented, such as speed of IT delivery (i.e., development and implementation time), reduction in transaction time for users and integration of valuable IT assets. Such metrics can indicate the efficiency level of IT initiatives across all areas of the organization.

- **Level 3 (Rationalize):** Seek business relevance, flexibility and agility.

It is imperative to focus on business goals and ensure that IT initiatives are aligned with business objectives and priorities. IT performance metrics should be closely tied to business metrics so that their alignment can be measured appropriately. Some of the metrics that could help with the measurement of an organization's business innovation include addition of new customers/users, ability to meet current and future functional needs and reduction in time to market of new products and services.

- **Level 4 (Transform):** Invest more to optimize more.

As economic conditions improve, companies can focus their cost optimization efforts on implementing long-term business and IT process improvements, enabling business growth and innovation, and repositioning the business to sustain a competitive advantage. As the percentage of IT investment aimed at business transformation increases, the percentage spent on business sustenance should remain constant or decline as operational efficiencies are achieved over time.

IT Cost Optimization Planning

Recognizing that cost optimization teams usually operate on tight timeframes, we have created a framework for prioritizing cost optimization techniques by considering not only the potential benefits in terms of savings, but also the time requirements, degree of organizational and technical risks, impact on customers, and investment required.

By evaluating the factors depicted in Figure 3 (see next page), CIOs can weigh the future strategic value, risks and benefits of cost optimization initiatives. In assessing options, decision-makers should also take into account:

- Time to complete the initiative.
- Tactical and organizational risk.
- Upfront cash investments required to achieve downstream savings.

IT Cost Optimization: Three-Step Approach

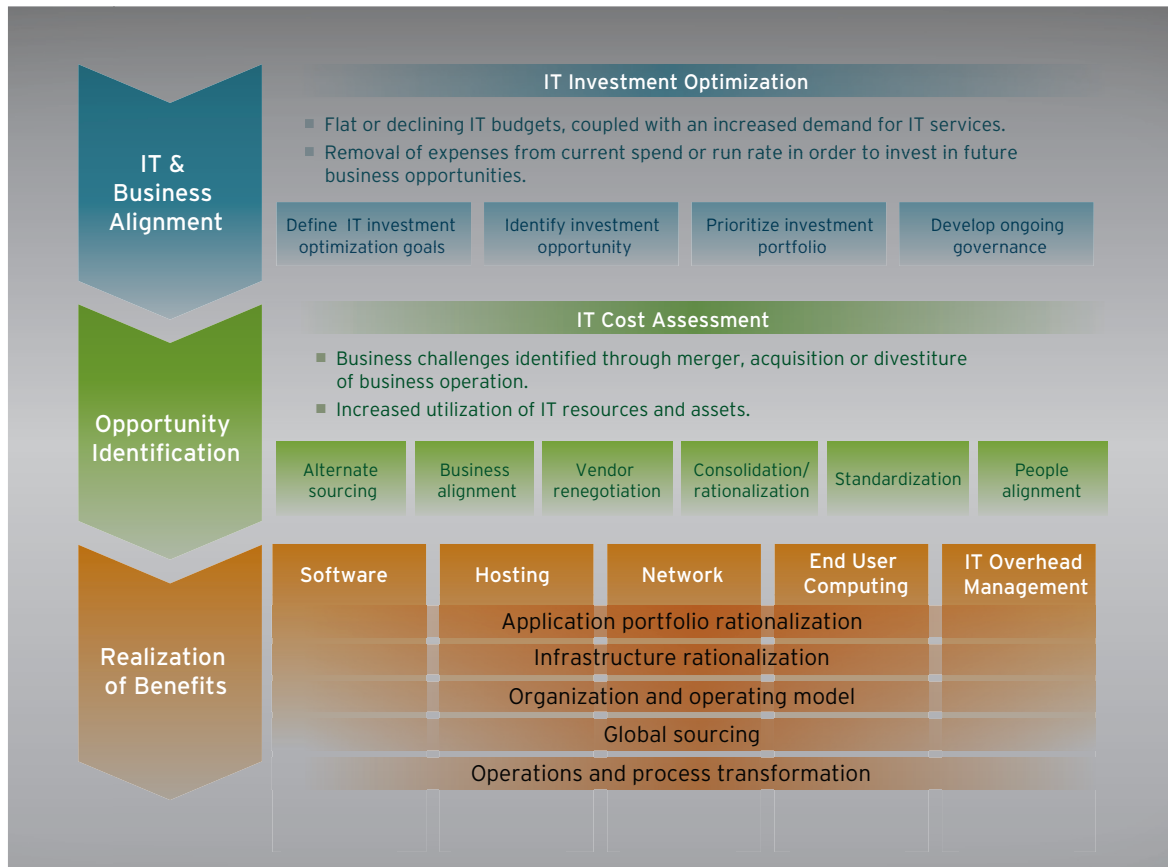


Figure 4

Our methodology assesses a core set of key organizational objectives (i.e., total cost savings, impact on customers, time requirements, degree of organizational and technical risk and required investment) for various IT cost optimization initiatives. When planned strategically, these objectives can result in a variety of benefits to IT organizations (see Figure 5).

Looking Forward

Business uncertainty will continue to impact IT organizations, and even a well-thought-out cost savings program can prove ineffective in the long run. However, when cost pressures are intense, businesses must overcome the dual challenge of continuously innovating while reducing spend to outperform the competition.

Overcoming these obstacles requires a strategic cost optimization program to strike a balance between cost reduction initiatives and investments needed to generate process efficiencies, improve quality of service, build a stronger value chain, improve skill management and increase customer satisfaction. Further, cost optimization cannot be a one-time strategic IT initiative. Instead, it should be a guiding principle for managing IT in the most efficient manner while responding promptly to fluctuations in business conditions.

IT Cost Optimization Initiative Benefits

ITCO Initiatives	Cognizant's Approach	Benefits
Application Portfolio Rationalization	<p>Portfolio Assessment</p> <ul style="list-style-type: none"> Assess the portfolio based on business and technology drivers. Conduct a cluster analysis to select the group of applications to be rationalized. Conduct a portability analysis to check how easily the portfolio can be migrated to target architecture. <p>Transformation Plan Definition</p> <ul style="list-style-type: none"> Define the plan to achieve the target architecture. Prepare the transformation roadmap. 	<p>Improved Cost Management</p> <ul style="list-style-type: none"> Reduce/contain costs without affecting service quality. Continuous IT spend optimization. <p>Increased Efficiency</p> <ul style="list-style-type: none"> Highly flexible IT portfolio. Improve analysis of system deficiencies, process constraints and risks from technology architecture perspective. <p>Business Transformation</p> <ul style="list-style-type: none"> Adapt to industry best practices. Seamless business transformation flow.
Infrastructure Rationalization	<p>Asset Optimization</p> <ul style="list-style-type: none"> Infrastructure standardization Desktop virtualization Printer fleet optimization <p>Contract Optimization</p> <ul style="list-style-type: none"> Procurement vendor and maintenance contract negotiations. <p>Overall Service Model</p> <ul style="list-style-type: none"> Patch management. Help desk support. OS upgrade. Security updates. 	<p>Cost Efficiencies</p> <ul style="list-style-type: none"> Reduce total cost of ownership. Reduce procurement and support service cost. <p>Increased Efficiency</p> <ul style="list-style-type: none"> Improve economies of scale by standardization of assets. Obtain operational efficiency by aligning to industry standards and investing in more optimization initiatives.
Organization and Operating Model	<p>IT Performance and Process Improvement</p> <ul style="list-style-type: none"> Maturity assessment. Process improvement roadmap. <p>IT Workforce and Skills Optimization</p> <ul style="list-style-type: none"> Workforce assessment and strategy. Suitability analysis. Governance and change management. <p>IT Organization and Governance Model</p> <ul style="list-style-type: none"> Current organization assessment. Future organization definition. Governance and transition recommendations. 	<p>Increased Cost Savings</p> <ul style="list-style-type: none"> Savings due to process standardization and reduced re-work. <p>Improved Product Quality and Service</p> <ul style="list-style-type: none"> Improve time to market by combining improved schedules with higher quality. <p>Increased Customer Satisfaction</p> <ul style="list-style-type: none"> Increased organization flexibility to respond to business demand.
Global Sourcing	<p>Needs Assessment</p> <ul style="list-style-type: none"> Identify strategic goals and baseline inventory. <p>Suitability Analysis</p> <ul style="list-style-type: none"> Portfolio maturity analysis. Service model definition. <p>Transition Planning & Financial Analysis</p> <ul style="list-style-type: none"> Resource planning. Financial analysis. Sourcing strategy. <p>Supplier Selection</p> <ul style="list-style-type: none"> Supplier selection, evaluation and finalization. 	<p>Strategic Advantage</p> <ul style="list-style-type: none"> Achieve competitive edge by investing IT cost savings into more forward-looking innovative ideas. <p>Cost Savings</p> <ul style="list-style-type: none"> Reduce cost for acquiring skills with prompt response to ramp-up and ramp-down situations. <p>Improved Skills Management</p> <ul style="list-style-type: none"> Leverage the best skills wherever they exist. Dedicated high-valued workforce for more important initiatives. <p>Long-term, Trusted Relationships</p> <ul style="list-style-type: none"> Co-development, benefit and risk sharing
Operations and Process Transformation	<p>Enterprise & Business Transformation Functions</p> <ul style="list-style-type: none"> Transformation driver identification. Current state assessment of capabilities, operating model and IT portfolio. Future state operating model definition, IT roadmap, sourcing model, architecture roadmap and governance framework. Transformation adoption roadmap. 	<p>Stronger Value Chain</p> <ul style="list-style-type: none"> Improve visibility of end-to-end value chain. Strengthen supplier and partner relationship. <p>Improved Demand Management</p> <ul style="list-style-type: none"> Increase demand forecast accuracy. <p>Improved Cost Management</p> <ul style="list-style-type: none"> Drive significant increase in bottom line.

Figure 5

Quick Take

Lighting Up IT

A leading electric utilities company in the U.S. engaged us to help the organization embrace a robust IT cost optimization methodology. The company's goals were to achieve significant cost savings across infrastructure, process and technology through:

- Reduced technology total cost of ownership and improved ROI.
- Effective sourcing of technology resources.
- Process and operations maturity.
- Tool rationalization and end-state planning.

We engaged with various business stakeholders within the organization to optimize and consolidate organization-wide processes through self-optimization and varied levels of sourcing approaches. We established clear service and operational level agreements (SLA and OLA) and used service automation to enable productivity improvements. The team rationalized the utility's infrastructure, application and tools costs, implemented enterprise monitoring standards and enabled end-to-end tools integration. Lastly, we implemented ITIL component capacity management (CCM) and SACM processes, including IT asset management.

Key benefits of the IT cost optimization framework program included:

Cost savings

People

- \$5M labor savings via self-optimization.
- \$9M average labor savings per year via selective sourcing.
- \$14M to \$19M average labor savings per year via full sourcing over a span of five years.

Tools

- \$1.6M software license savings as a result of consolidation.
- \$3.4M in labor savings through end-to-end integration and automation.
- 20% reduction in overlapping tools.

Technology

- \$9M estimated savings via technology optimization.
- Reduction in Op-Ex (i.e., vendor support and software costs) by as much as 20% in full-time staff supporting network operations.
- Approximately 15% to 20% cost savings in 85% of virtualized environments.

Process

- Improved cost-capacity balance.
- Improved system availability and productivity against capacity issues.
- Cost avoidance on duplication of tools, data sources and processes.

Effective Demand Management

- Establishment of an effective demand/forecast process for capacity.

Better Skill Management

- Cross-training of resources to enhance resource utilization and improve focus on strategic activities.
- Selective use of third parties for low-skilled activities and gradual increase of offshore resources.

Better Product Quality

- Improvement in client's perception of quality.
- Robust SLAs and OLAs across the organization.
- Reduced time to solution of complex issues/problems.

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About Cognizant

Cognizant (NASDAQ: CTSH) is a leading provider of information technology, consulting, and business process outsourcing services, dedicated to helping the world's leading companies build stronger businesses. Headquartered in Teaneck, New Jersey (U.S.), Cognizant combines a passion for client satisfaction, technology innovation, deep industry and business process expertise, and a global, collaborative workforce that embodies the future of work. With over 50 delivery centers worldwide and approximately 171,400 employees as of December 31, 2013, Cognizant is a member of the NASDAQ-100, the S&P 500, the Forbes Global 2000, and the Fortune 500 and is ranked among the top performing and fastest growing companies in the world. Visit us online at www.cognizant.com or follow us on Twitter: Cognizant.

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