

## Seven habits of effective IT governance: commentary with Christian Hagen



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You can't pick up a newspaper or turn on the television today without reading or hearing about a serious technology mishap. An IT security breach at discount retailer TJX, owner of T.J. Maxx and Marshalls in the United States, exposed millions of customer credit card accounts to potential fraud. Overwhelming online demand for tickets to the baseball World Series in Boston and the Olympics in Beijing triggered system-wide failures. And what about the JetBlue fiasco? The discount airliner cancelled hundreds of flights and stranded thousands of passengers when its flight-operations system could not handle changes in its crew schedules and flight conditions.

Is this the wave of the future? Will companies lose customers and market capitalization due to IT failures? It's hard to predict what may happen, but there is the potential for companies of all sizes to experience similar IT disasters. Some companies will survive, but many others may fail due to inefficient IT systems and platforms, bringing sales and operations to a halt, and leaving scant time for a successful recovery. The executives and board members responsible for future IT failures may become as infamous as Enron, with millions of dissatisfied customers and shareholders left in the dust.

Today, senior executives, boards of directors and shareholders are demanding more effective governance of their IT organizations. Companies know serious IT failures create chaos not only with business operations but also with customer relationships. Restoring customer confidence and brand loyalty can take years and costs millions of dollars. At a time when profits are down and some companies are struggling just to survive, an IT disaster can threaten a company's existence.

### Building effective IT governance

During sustained periods of change, old systems can fail. Many companies formed IT Governance Councils to prevent IT disasters and improve the management of day-to-day operations. Primarily focused on process-based functions and tactical needs, these councils draw up guidelines for effective compliance and risk management. While these guidelines are a good start, they do not take IT Governance far enough. Businesses need a new equation – one that makes IT Governance a strategic component of the overall corporate strategy.

We have observed seven habits for gaining maximum value from IT Governance. The most successful companies are those that have matured beyond simply linking IT strategy

and the business, and instead have established a fully integrated operating environment. The following offers an in-depth discussion of the seven habits of effective IT Governance.

### **IT is viewed as a strategic business asset and managed as a portfolio**

Top companies view IT holistically, as a strategic business asset. IT costs consume about four per cent of the average company's corporate revenues, and up to a quarter of operating expenses, which in some cases is larger than all other corporate functions and investments. Thus, as with other major business areas, top companies treat IT assets as a portfolio rather than an independent series of projects. Doing so allows for a better understanding of where particular strategies can be applied, and what value can be brought to the business.

Ideally, the portfolio focus is in three areas – operations, business enablement, and innovation – where IT can have a significant impact on shareholder value and the bottom line.

- *Operations.* Manage mature and data-centre technologies to improve information systems and support services, establishing higher levels of effectiveness and cost efficiency.
- *Business enablement.* Managing IT tools that can transform or improve the company's core business processes to take business operations to world-class levels. The measure of success is not merely cost reduction, but also enhanced processes and profitability.
- *Innovation.* Managing technologies that can help achieve breakthrough innovation to create competitive strategies and transform market dynamics. Such technologies can reposition the company against its competitors or allow it to enter markets in which it did not previously compete.

By viewing IT as a portfolio, senior management focuses on how each technology contributes to business success, attaining a clearer sense of the level of human and monetary resources to devote to each type of technology. (Interestingly, most companies dedicate the fewest resources to innovation, which represents the biggest opportunity to increase shareholder value.)

### **Technology ignorance is not accepted. IT participates in technology investment decisions**

A big challenge for a company is deciding at what point to invest in new technology. The decision requires executives to stay informed and have the necessary skills and tools to know when to adopt emerging technologies. Our research reveals the best time for adoption is generally in the early adopter stage – after technology has matured into a business solution and when value derived from the technology has become more tangible. Companies that adopt technology in this stage typically outperform their competitors.

We are often asked how a company can determine if a new technology is worth the investment. Our answer: Evaluate the investment from both a technical and business context – determining its affect on competitive positioning and the bottom line. The following are central to the evaluation:

- *Costs.* The cost of implementing technology declines as the technology matures, so when evaluating a technology investment, all costs are considered, including direct IT costs of development, maintenance, and portfolio management.
- *Value.* The real value is not in the technology, but in the realization of a new business solution or process. A business solution can lag behind technology by months or years.

- *Strategic alternatives.* An early investment in technology may or may not pave the way for future technologies or profitable and strategic business options. Those that provide the most downstream options should receive serious investment consideration

Although companies can't guarantee stellar returns on emerging technologies, they can take steps to minimize their risk and maximize their potential. By understanding the solutions, how to evaluate them against desired value, and when it is appropriate to adopt new technologies, companies can reap more from their investments.

### IT has Board of Director-level oversight and clear executive leadership

Tyco International, Ltd., FedEx and JPMorgan Chase & Co. are just three of the many Fortune 1,000 companies with established corporate-level IT Governance Councils. These councils, with responsibilities and business impact comparable to those of the compliance, audit and compensation committees, report regularly to the Board of Directors. The IT Council and board have two primary responsibilities:

1. to ensure IT is aligned with the business strategy; and
2. to assess the performance of IT across several key areas.

Let's take a closer look at what each means:

**Ensure alignment with the business strategy.** The IT Council and board evaluate the role of IT and determine whether it supports the organization's business strategies and objectives. One mistake that councils make is failing to get the basics right and eventually losing all credibility. To avoid such missteps, leading companies first ensure that IT is effectively managed and does not fail the business – employing tactics such as risk mitigation, service-level agreements, and codified backup and recovery techniques. Over time, as the council's capabilities mature and evolve it will be better positioned to work with the business and the board as a strategic partner.

**Assess IT performance.** The next step is setting the right agenda and topics for the IT Council and Board of Directors to manage. Their responsibilities are mainly in three areas:

1. *IT portfolio.* Ensure the IT portfolio supports business goals and delivers innovative business solutions, primarily generating appropriate returns on the cost of capital, and ensuring assets continue to deliver value and are upgraded over time.
2. *IT and business continuity.* Analyze and manage the major risks associated with IT, including data protection, backup and recovery mechanisms, and business continuity plans. Board input is necessary to ensure appropriate risk levels, contingency plans and manual processes are in place in the event they are needed.
3. *Assessment and communication.* Assess the performance of IT continually to ensure effective delivery. This includes overall evaluation of technology, benchmarking against competitors and best practices, and measuring IT against its stated goals. Several key questions will help the board and IC Council members assess IT Governance competencies. The answers will help identify initial opportunities and priorities.

### There is no “one-size-fits-all” IT governance model

A one-size-fits-all approach to technology almost never works, especially for business units with different markets, products, channels, and customer needs. IT Governance at its best reaches a balance – broad enough to function across all business units but specific enough to address the unique needs of each. From an organization design perspective, the critical question is how centralized the governance model should be. The answer can be summarized in three points across a scale of governance behaviour – *enterprise-wide, federation, and business unit autonomy.*

Larger organizations, with similar IT needs across business units, often lean toward the enterprise-wide approach, using their size and economies of scale to cut costs and fulfil common needs. At the other extreme is business unit autonomy, which allows individual business units to control their own IT resources and strategic direction – an approach that enables IT delivery for discrete business units with unrelated business needs and capabilities. There are pros and cons to both approaches. With the enterprise-wide model, companies can cut costs, improve operability and maintenance; but they may sacrifice responsiveness to end-users and business units. The autonomy model allows business units to be independent, which facilitates responsiveness and speed to market, but can result in higher costs and less standardization.

The third governance model, federation, attempts to incorporate the most positive characteristics of the two extremes. It establishes alliances and formal governance processes to not only realize enterprise-wide opportunities but also allow business units to control their own IT needs.

### **IT is an essential part of corporate planning and strategy**

Almost 85 per cent of companies, according to a recent survey, have a formal IT Governance structure, or are actively developing one. Roughly 72 per cent of business executives believe the success of their business strategies depends heavily on IT, and 71 per cent say that investment in IT is proposed with the associated return on investment. But thinking that IT should be aligned with the business and actually aligning it are entirely different matters. In a separate A.T. Kearney research effort, only one-third of the companies researched categorize their IT planning as "aligned" with business strategy. These findings highlight the need for two-way communications in which IT shapes the direction of the business and the business shapes the strategic course for IT.

FedEx's pioneering package-tracking system, a key competitive advantage for decades, would not have been possible without a strong link to IT. Rob Carter, chief information officer for FedEx, calls the IT organization "the competitive glue that holds all of our business units together." Carter serves on the five-person executive committee that plans and executes the company's strategic business activities.

### **IT plays an active leadership role in transformation and innovation**

Given its involvement in all aspects of a business, IT has a unique vantage point to steer innovation within business operations. The IT group not only sees all processes across the company but also the opportunities to improve them. When IT and the business units jointly own innovation initiatives, they ensure that only the highest-value projects are selected, with IT Governance overseeing the projects so they are managed appropriately from beginning to end.

Encouraging innovation is almost always worth the effort. According to our research, growth rates for innovative companies are 68 per cent higher than their less innovative competitors, while 63 per cent of early adopters of technology quickly outgrow their competition. Top companies establish innovation, research and development (R&D), or advanced technology groups to continually probe the market for the next leading-edge technology – turning technology innovation into positive business results. For example, Apple's ability to constantly drive innovation into their product lines has led to superior performance in PCs, music accessories, and mobile devices. As an added bonus, Apple has done this by spending a little more than three per cent of its revenue on R&D.

### **IT's impact on the business is measured and monitored**

The final habit of effective IT Governance is measuring the quality and cost-competitiveness of the IT capability, treating it as any other vital piece of the business. In the past, measuring IT performance mostly involved tracking technical performance (uptime and number of severe events) and costs (IT spending as a percentage of revenues or per user). This data was not only limited but also typically viewed only by IT professionals.

Today, measuring IT performance has improved but is still not ideal. According to Gartner, only 40 per cent of companies measure IT's impact after implementation. Without tracking, most companies miss the opportunity to quantify what works and fix, replace, or discontinue those IT systems that do not support profitability.

IT Governance and oversight councils can ensure that boards and senior managers regularly measure and monitor IT performance. With the fast pace of business, such efforts may diminish over time, but they are vital to an IT department that positions the business for success.

### Developing the right habits

While it may take a year or more to implement an IT Governance programme, the first three months are the most noticeably productive. This is the time to identify members of the IT Governance Council (with representatives across functions), make the business case for the most deserving projects and programmes, and track performance and results. The following are essential to a successful IT Governance implementation:

- Identify the optimal IT Governance model based on the needs of the business units and current IT capabilities.
- Determine the major structures needed to manage IT Governance. The structures include risk management, a cross-functional oversight committee and a sub-committee of the Board of Directors. Accountability is assigned to top-level executives who understand how their performance will be evaluated and communicated to the board.
- Clarify the current standing of the IT asset portfolio, including assessing IT systems to determine operational levels now and what will be needed in the future. Instil the seven habits for IT Governance in the overall structure and manage the related committees and councils

Companies with highly effective IT Governance prioritize and communicate the structures, topics, and essential changes across the organization, involving both IT and business leaders. Bringing together upper management is vital for ensuring a detailed look at how closely tied IT is to business performance. Effective IT Governance is a long journey, but success can be realized by those that understand the path – and the seven habits that keep them on course.

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