



# Balancing the IT portfolio for **risk and reward**

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**IT executives know** that the right investments in technology can deliver a significant competitive advantage. Over the past 50 years, companies such as American Airlines, Apple Computer, Frito-Lay, Google, and Wal-Mart Stores have changed the competitive rules in their respective sectors by introducing technology-enabled innovations. But at many companies today, CIOs and their departments struggle against the perception of their business peers that their job is simply to keep the e-mail working and deliver narrowly scoped projects, not to champion investments in innovation. This limited view of IT's role became prominent as the e-business boom of the late 1990s ended and business executives tried to rein in spending and to ensure that IT investments served business goals. More recently, it has been nurtured by the popular argument that IT is a commodity like electricity, to be managed at minimal cost. "Do more with less," has become a popular mantra.

i Focusing exclusively on bottom-line costs, however, limits the top-line potential. By forgoing investments in IT innovation, companies are passing up opportunities to gain a competitive advantage or to change the rules in their industries fundamentally. Yet some companies with a broader vision have pursued IT opportunities. To understand how these companies invest in innovation and manage the accompanying risks while running their basic IT functions as efficiently as possible, we assessed the IT strategies of several leading global organizations. We found that IT can be used as a competitive weapon, but managing IT to deliver on that promise requires a differentiated approach that many companies find difficult to implement because they either fail to see the potential or don't distinguish between commodity IT services and innovation.

**Article at a glance**

*Companies manage established businesses and new ventures differently. But too often, they manage information technology with a broad stroke to build scale, improve productivity, and cut costs.*

*While managing for cost may be appropriate in much of IT, companies risk missing opportunities for speedy development and unique innovation if they fail to govern IT as they govern their businesses—with different rules and metrics for different parts of the organization.*

*In this model, companies should tightly integrate basic IT services with other back-office operations and manage them all for scale efficiently. IT services that help businesses develop new products for competitive advantage should be integrated with those businesses.*

*Additionally, companies must find ways to manage IT investments aimed not only at helping current businesses achieve competitive advantage but also at developing new businesses that can change the rules of an industry.*

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Specifically, companies should manage their investments in IT as they manage their financial investments, categorizing them as low, medium, and high risk. Typically, most of a company's IT investments (up to 60 percent, depending on its market position and aspirations) should focus on maintaining and enhancing basic IT services, including core business applications, systems to meet regulatory demands, e-mail, and Web services. These are low-risk, stay-in-the-race functions (exhibit, on the next page).

An additional 10 to 30 percent of a company's IT investments (or more, depending on its aspirations) should aim to help it win the race in its sector. These investments—for example, automating online lending-approval processes or automatically providing call center agents with each customer's service history—help a business operate at significantly lower cost or higher productivity than its competitors do. Such investments yield cost advantages over rivals, at least until they implement similar systems and processes.

More difficult to manage is a smaller category of high-risk, high-reward investments that focus on changing the rules within the sector: innovations that open new markets or make it possible to offer new products or services that are substantially different from and more desirable than those of competitors.

By differentiating among the way these categories are managed, companies can run their daily IT operations cost effectively while making limited, targeted investments in new and promising technologies. Doing so requires getting right the difficult governance issues that arise as companies segment their IT portfolios. It also means managing the migration of IT capabilities as they follow the inevitable life cycle from cutting edge to commodity. Finally, companies taking a differentiated approach to IT will likely need

EXHIBIT

How to slice the IT pie

% of company's total IT investment:

IT investment categories<sup>2</sup>

- Change the rules
- Win the race
- Stay in the race

Aspiration for growth<sup>1</sup>

High: companies investing in rapid growth

Low: companies defending (or marginally increasing) market share

**Case 3** Global leader, capturing disproportionate share of wallet through product innovation



**Case 4** High-performing US credit card provider entering European market



**Case 1** Mutual bank, local incumbent, trying to merge platforms, reduce cost-to-income ratio by 10 points



**Case 2** Global player engaged in cross-border mergers and building global operating model



Low

High

Operating performance vs peer group

<sup>1</sup>By business unit or line of business.

<sup>2</sup>Change the rules = investments that open new markets or offer new product, service; win the race = investments that lower costs or increase productivity (eg, automating online lending-approval process); stay in the race = investments that maintain basic IT services (eg, e-mail).

to rethink how they manage IT innovation and to redouble their efforts to build innovation capabilities.

Three types of IT management

When companies manage all of IT at the project level or within business units, the priority is inevitably the immediate need to win or stay in the race. The approval of new projects depends primarily on their savings potential or the business case. By contrast, companies that adopt a portfolio approach can direct some of their investments toward innovations that may help them enter new markets or change the game in existing ones. A portfolio approach lets managers articulate clear guidelines for accepting some degree of risk in exchange for a payoff that delivers a competitive advantage.

A leading European investment bank that adopted this approach over a five-year period balanced its portfolio of IT initiatives across the three categories. In its everyday scale projects (stay-in-the-race investments), it rationalized the number of applications it used by decommissioning more than 20 of them in its trading business (in order to reduce the level of duplication and the cost of complexity), simplified its infrastructure by standardizing hardware and operating systems, and created fail-safe disaster recovery capabilities to protect its business operations, whose stability rose by 15 percent. The bank's win-the-race projects aimed to improve the speed, reliability, and efficiency of its trading operations while also reducing the number of errors by automating data entry among its clients.

The portfolio approach also allowed this bank to create the IT capacity to innovate in ways that could change the rules in its industry or allow it to succeed with the current model by offering better products. Developers in the front office, for example, used rapid programming techniques that helped them bring new trading products to market in hours instead of the days or weeks that would have been required had they used a more standard approach. Thus, the bank could quickly develop new products to meet the needs of its clients. These initiatives, executed over time, not only positioned the bank in new, high-margin growth businesses but also created a significant cost and service advantage that was difficult for competitors to replicate. While none of these initiatives was truly distinctive, the decision to use IT for competitive advantage across a range of products and services helped the bank improve its trading volume by more than 400 percent over the five-year period while cutting its operating costs by 25 percent.

Successful organizations like this bank tend to group their investments into three categories:

1. *Scale IT investments.* Stay-in-the-race projects involve the most familiar applications of information technology—those that are necessary to compete in a market and must be managed for cost. The IT priorities in this category should be to reduce operational costs and to ensure appropriate service and quality levels, but these investments alone will not create a competitive advantage. By automating and consolidating back-office operations, for example, a global company can cut its costs and raise service levels, but it probably won't change its industry standing. Typically, a company with a strong position in a mature market devotes 30 to 60 percent of its IT investments to this category; attackers may spend less.
2. *Competitive-advantage investments.* Win-the-race investments improve service, cut prices, and increase the effectiveness of decision making or

the efficiency of operations. Companies should select and manage such projects in close alignment with other business and operational investments. In the 1990s, Wal-Mart linked its supplier warehouses and stores in a single supply chain system, which allowed it to operate with significantly less inventory while reducing the incidence of stock-outs. For several years, these achievements gave the retailer a significant cost advantage over its similarly scaled competitors, fueling its growth while they attempted to catch up by developing similar systems. Likewise, the first airlines that introduced electronic check-in booths at airports reduced the cost of check-ins significantly (in some cases by as much as 75 percent) while offering a faster and more convenient service. Now, 20 percent of all customer journeys start at an electronic check-in booth, and such facilities are the norm for all major airlines.

*Rule-changing investments.* Change-the-rules investments deliver a competitive advantage by creating new and unique products or services or by generating hard-to-replicate cost or performance advantages. In 2004 Barclays Capital launched Barx, a global 24-hour electronic trading platform for financial products. Barx not only cut costs and response times by removing the phone and paper parts of the processing chain but also created a new electronic marketplace for interest rate swaps and subsequent offerings. That marketplace has become the norm for the electronic trading of these products. In this case, Barclays Capital was a successful attacker, taking market share away from bigger investment banks. Attackers spend a relatively large part of their IT investment budget on projects in this category—in some cases, up to 40 percent of the total.

Organizations that focus only on short-term stay-in-the-race or win-the-race projects miss out on IT investments that could help them change the rules and leave their competitors in the dust. By distinguishing among different kinds of IT investments, companies can use technology not only to attain competitive parity but also to deliver significant top-line growth and competitive advantage.

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