

## **Managing for scale, speed, and innovation**

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Companies must govern IT as they govern their businesses: with different rules and metrics for different parts of the organization.

The CIO of a large company with global operations faced a problem. The CEO had asked him to manage the company's shared services for finance, human resources, and procurement. On the one hand, the CIO thought it made sense to have one person in charge as the company standardized its back-office activities on a common enterprise- resource-planning (ERP) platform and moved some of them to low-cost locations. Such a program fit in well with the CIO's advocacy of better integration between IT and business functions. On the other hand, he was concerned that combining commodity services with information technology would send the wrong message to the business units, since he had been urging them to view IT as a strategic function. He also worried that running back-office shared services in a strict and standard way, giving virtually no flexibility to the business units, would conflict with his goal of building a collaborative partnership with them in order to use technology to win in the marketplace.

This CIO's difficulty is becoming increasingly common. Leading companies are aggressively standardizing the back office globally, so they can operate efficiently and free business unit leaders to focus on getting products to market faster and commercializing them more effectively. These companies are also taking more risks, experimenting with ideas that will disrupt existing business models. This growing multiplicity of ways for IT to support strategies has exacerbated communication problems between IT and the business—problems that have long been a source of dissatisfaction for both sides. Traditional fixes such as governance bodies and processes are increasingly overengineered and don't always deliver the hoped-for results.<sup>1</sup>

Our work with companies in many sectors shows that the answer involves adopting what we call differentiated IT governance: integrating IT with the business area it supports and matching the management of IT to the management of the business. A few leading companies, for example, manage the information technology that supports the global back office for scale while they manage the information technology that supports front-office functions for speed and distinctiveness—with different leaders, structures, decision-making processes, skills, and incentives for each. In addition, these companies are searching for ways to manage IT-enabled business innovation apart from the rest of the business, using different metrics. (For a detailed description of how to set IT strategy around differentiation, see "Divide and conquer: Rethinking IT strategy.")

This new approach must also be dynamic: over time, cutting-edge IT-enabled business capabilities become commodity systems as rivals adopt them. Managing that migration is an additional challenge for executives. A few years ago, for instance, electronic data capture was a new force in the pharmaceutical sector, where it helped pioneering companies gain a competitive edge in clinical development. At the time, developers of these systems had to allow for customization. Today electronic data capture is more prevalent in the sector—a requirement to stay in the race—so companies must now focus on ensuring the use of off-the-shelf packages and standard, low-risk operations. Companies also need to be more proactive about migrating tasks from one category to another. While most technologies move downstream, from cutting edge to commodity, a few head in the opposite direction—for instance, when simple transactions can be analyzed more carefully to deliver new insights. At many companies, however, the interface between businesses and IT has become too complicated to ensure that these requirements are addressed as they change.

Finally, while most companies have experience managing IT for efficiency or for speed and business responsiveness, far fewer know how to harness IT-enabled business innovations for competitive advantage. Without an adequate investment in innovation, companies can't seed the front end of the technology cycle with ideas that will help them enter new businesses or change the rules in existing ones.

## **Align IT governance with the business**

The trend over the past decade to centralize IT has cut costs, strengthened compliance with corporate standards, simplified vendor management, and improved the way companies manage the demand for and the delivery of their IT services. The downside is that these changes often distance technology from the business. Communication between business and technology leaders is often tightly structured to comply with new controls aimed at reducing waste and ensuring that everyone requesting IT services is treated equitably. When business executives grow less familiar with technology's evolving capabilities and technologists grow less familiar with the business, collaborative problem solving becomes more difficult. At one investment bank with pooled IT resources, for example, management found that the tech staff was losing touch with the bank's current product offerings—a gap that lengthened the time needed to develop new products.

Equally important, isolating IT makes it harder to leverage technology that could change the business model. Process innovations enabled by new technologies frequently help companies leap ahead of their competitors, but when IT is constrained too tightly, no funding is available for investment, and a risk-averse culture can develop. In some cases strict control backfires, encouraging informal back channels where rigid governance is circumvented and shadow IT organizations spring up. These developments occurred for example, at a bank where managers were ignoring investment rules in order to finance new development projects, which in turn left vital regulatory projects without adequate budgets and behind schedule.

Companies can avoid these problems and get more from their technology investments by abandoning a one-size-fits-all mind-set for governance and adopting a model that lets three groups pursue different objectives while each group integrates with the business function it supports.

## **Managed for scale**

As more companies standardize their back-office business services<sup>2</sup> and try to reduce costs, they want IT to enforce standards through ERP packages that implement common business policies throughout the organization. To do so, such companies typically put all of these functions, including IT support, under a leader with a track record for operational excellence—sometimes an IT leader who has driven a standardization effort and in other cases a business executive.

By empowering a single leader to make investment decisions across IT, process redesign, training, and global sourcing, companies hope to reduce their back-office costs by 20 to 40 percent over two to three years and then by 3 to 5 percent each year thereafter. Some of these savings may come from replacing a smorgasbord of existing legacy systems with a common platform, which can make maintenance less expensive and more reliable. As these back-office leaders standardize operations, they must balance the business's need for ease of use with their mandate from the top to enforce compliance. As a trade-off for going along with the new program, business units save money on these services and can focus on winning in the marketplace.

## **Rapid development for competitive advantage**

To create a competitive advantage, IT that helps business units win in their markets—by improving the speed, efficiency, or interface of products or by making it possible to develop new products rapidly—should be closely aligned with or embedded in the business group the IT supports. Decisions about IT investments should be based on whether they will confer an advantage in the marketplace; optimization efforts should aim to get new products or services into the market ahead of the competition.

This approach works best when business unit leaders are as knowledgeable about deploying IT to win as they are about deploying capital or human resources.

Raising the "IT IQ" of business leaders often delivers a significant payback. In addition, the IT leader supporting the business unit should be savvy enough about it to have insightful ideas on how IT can help it win. At one investment bank, for example, small specialist units of IT developers sit with front-office teams and report directly to them. Developers are reviewed and compensated based on the success of the business.

### **IT-enabled business innovation**

Even in industries where technology isn't the business, new investments in it can have a rule-changing or disruptive effect. Applying the same investment barrier used by business units—that investments must be responsive to their needs—may lead companies to miss out on disruptive opportunities falling outside any particular unit. For that reason, some companies explore new innovations outside of business units. These companies set up innovation groups where a higher level of risk is acceptable and managers often are measured on the value that success would generate. Even if only one in five experiments is robust enough to advance to the next stage, when a business unit leader takes responsibility, the innovation group might be considered successful.

### **Migrating tasks from one level to another**

Although companies must differentiate the governance of each group by leadership, structure, decision-making rules, skills, and incentives, they must also coordinate across the groups to ensure that as a capability matures from cutting edge to commodity, it can be smoothly transferred from one group to another.

Creating a mechanism for that purpose is just as important as setting up the proper governance for each group. Without such a mechanism, IT may go on investing too much in technologies that no longer confer any competitive advantage. That's what happened at a consumer products company that continued to manage finance, procure-to-pay, and billing systems as if they provided a competitive differentiation long after they had become commodities. The company was spending over 30 percent more on these services than it had to—money that should have been invested in new areas to differentiate itself in the marketplace.

Most companies tend to reexamine the way they manage their capabilities only during events such as mergers or cost-cutting programs. But the leading companies have a more proactive process to weigh capabilities annually and to shift them from one group to another.

### **From innovation to business alignment**

Companies find different ways to determine when their IT investments in innovative, potentially disruptive technologies are ready to be managed by business units for competitive advantage. The most common approach is to make business leaders accountable for commercializing the idea, while moving a cadre of technologists responsible for it into the appropriate business unit. The business then has to set top- and bottom-line goals for the contribution the idea should make to the company's value. In some cases, the chief executive may create a new unit to commercialize the idea, particularly when it suggests a new business or product or threatens an existing business.

We have seen other successful approaches as well. A media company performs an annual review of the technologies used by its competitors. A consumer products company created an internal innovation futures market, where managers can go long or short on innovative ideas pitched by the teams creating them. Once the market price of an idea crosses a threshold, the innovators get more funding; if it crosses a higher threshold, it's transferred into an existing or new business unit. But if its price falls below a certain level, it gets killed.

### **From business alignment to scale**

Similarly, businesses should evaluate whether their capabilities are still creating a competitive advantage or should be moved to shared services or otherwise managed for scale. Some companies tie this evaluation to the annual budgeting process.

Once a business decides to manage a capability for scale, there are at least three ways to migrate it. The most popular is to move its business processes, systems, and people into the scale organization and let them rationalize it. One company, for example, moved the bulk of the finance functions and systems embedded in various business units into a shared-services organization that uses a standard enterprise system. Another method, now becoming increasingly popular, is to create a standard capability within the scale organization and to transfer the service incrementally, with the business unit responsible for redeploying or retiring the related systems and people. Finally, in corporate environments where autonomy is strong or the technology behind the capability is already meshed tightly with scale operations, companies can apply budgetary constraints to the business unit and require it to conform to scale standards and policies.

Shared-services organizations are increasingly becoming a source of innovation on their own. See "Running a customer service center in India: An interview with the head of operations for Dell India."

### **From scale to business alignment or innovation**

Most IT and business activities move over time from innovation to business alignment to scale, but occasionally the reverse is true. Many retailers, for example, now combine data from loyalty cards and transactions to understand the individual consumer's buying patterns. As a result, the collection, storage, and analysis of transaction data—once clearly scale functions—have become a competitive weapon and should be governed for business alignment.

Companies need to ensure that they can spot these changes and transfer activities accordingly. A common signal is frustration on the part of the business with the scale organization's flexibility and speed in specific capabilities. Migrating a business capability in this unusual upstream direction typically requires moving people from the scale group to newly created positions in the businesses.

### **Strengthen innovation capabilities**

Most companies already have dedicated IT capabilities to carry out activities that help deliver a competitive advantage (win-the-race capabilities) or to manage technologies at scale (stay-in-the-race ones). Far fewer have strengthened their capabilities to *change* the rules in ways that their strategy might suggest. In many cases management hasn't defined its aspirations for technology-led innovation or evaluated how well the current IT structure promotes them. In others the aspirations may be clear, but the companies haven't agreed on the level of investment in capital and experienced talent needed to meet them. Sometimes the way companies manage innovation lacks accountability for results. The process of getting leaders to agree on the right level of investment can highlight a "reality gap": the difference between what a company says it wants to accomplish and what it's willing to invest. Four successful models are emerging for investments in innovation.

1. **Venture capital model.** Some organizations rely on third parties to innovate for them, using strategic investments and acquisitions to gain access to new technologies and the associated business models. Usually a team of senior innovation leaders—executives with high credibility, proven business and technology chops, and an appetite for risk—work together to identify and invest in these technologies and bring them into the company. Several telcos, for example, recently created such groups to find the capabilities that will shape the next generation of products.
2. **Innovation networks.** Some players choose to tap wide-ranging external networks in academia, in hotbeds of start-up activity, and in their strategic IT vendors or partners. Ideas generated via this model are further developed by small internal teams and

brought to a network of business leaders orchestrated by the CIO. (For a description of BP's approach to deploying such a model, see "Managing innovation: An interview with BP's CIO, John Leggate," a sidebar to "Divide and conquer: Rethinking IT strategy.")

3. **Innovation factory.** Other companies create a separate organizational unit with a start-up atmosphere, where unstructured teams from business, IT, finance, and other disciplines work together to develop and evaluate innovative ideas. An investment bank, for example, has teamed its former CIO with a former business unit leader; they jointly run a new unit tasked with creating and delivering market-leading electronic services (for example, prime brokerage) to clients. Once services have proved their value to customers, the company transfers ownership of the platform to the relevant business group.
4. **Skunk Works.** In banking and telecommunications, we've seen companies develop and deploy new IT-enabled products and services from within existing IT organizations by setting up a small development unit headed by entrepreneurial technology leaders who understand the needs of the business. At a telco whose CIO has a successful track record developing and deploying innovative products and services outside the company's formal processes, new solutions are tested in a small market. Those that succeed are then offered to the rest of the organization.

All of these models require visionary and entrepreneurial leadership with deep knowledge of business and technology, as well as sponsorship from senior management—typically the CEO. Such sponsorship implies access to dedicated investment funding. In addition, a performance-management and incentive system that encourages appropriate risk taking holds the leaders accountable.

In many companies CIOs struggle against the perception that their job is merely to keep the e-mail flowing. After all, CEOs know immediately when basic services fail but are less aware when investments in new technologies fall short or, even more problematic, when companies aren't making the IT investments they need to refresh their businesses. By structuring and governing different aspects of IT to deliver on different goals, companies can be more confident that they are getting the most from their IT investments. 

**Fonte: The McKinsey Quarterly, n. 4, p. 87-93, 2006.**