

McKinsey on IT

An in-depth look at the challenges facing senior managers

Published by McKinsey's global IT practice

July 2004



Next-generation CIOs

To ensure that IT investments have the greatest impact, CIOs must involve business-unit leaders and concentrate on the big picture.

Article at a glance: Chief executives have been disappointed that IT hasn't done more to improve corporate performance. Some chief information officers are stepping up to that challenge, going beyond their traditional IT-management role and working closely with business-unit leaders to make the most of technology investments.

Take-away: To step up to the new responsibilities of an IT leader, CIOs must delegate or shed some operational duties and spend more time helping business leaders identify and use technologies that will help companies innovate.

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To ensure that IT investments have the greatest impact, CIOs must involve business-unit leaders and concentrate on the big picture.

David Mark and
Eric Monnoyer

Many chief information officers do an excellent job of overseeing IT operations, but very few lead their companies' efforts to get real business benefits from IT investments. A new style of leader is needed—one who can find ways for IT to change the company, not just run it. Are CIOs up to the challenge?

Case in point: The CIO of a large European bank instilled discipline and focus in the IT organization, reduced IT costs, streamlined and upgraded the infrastructure, and showed the business units that IT mattered. From an enterprise perspective, however, the CIO's performance was not so impressive. First, the IT budget focused on maintaining bank operations, not on innovating to add business value. Second, technology operations and investments were not aligned with the bank's business strategies.

The bank's CFO proposed an alliance. The two executives would involve business-unit leaders in defining the bank's IT agenda. They would begin, the CFO suggested, by helping the business leaders see the impact of their decisions on IT costs. At the CFO's behest, IT reports on operating costs and reliability were replaced with reports focusing on IT-driven business and financial metrics, such as business-process errors. The CFO also sold the bank on a new decision-making process for technology investments—one requiring greater business-unit involvement. Over time, persuaded by facts, influence, and deal making, the business-unit leaders became more deeply engaged in initiatives to reduce IT costs stemming from business complexity.¹ Today these

executives are making smarter decisions about IT investments and are more accountable for the outcomes.

Who was the real IT leader at the bank—the CIO or the CFO? The answer is obvious: the CFO drove efforts to take IT to the next level. While some CIOs may be content to manage their IT organizations efficiently, those who aspire to a greater role will need to make a choice in the next few years: step up to the new responsibilities required of an IT leader or watch as another executive does.

At many companies in Europe and North America, CIOs have been optimizing IT assets successfully. But at a growing number of these businesses, CEOs say they are disappointed that IT hasn't done more to improve corporate performance (see sidebar, "What CEOs really think about IT"). CEOs and many CIOs agree on the components needed to manage IT for value—including more business-unit involvement in technology-investment decisions, greater business accountability for realizing the benefits of those investments, and an increased emphasis on using IT to change the company rather than just to run it. The missing ingredient is the leadership needed to make these changes real.

Let's be clear: this article is not suggesting—as many have, for many years—that CIOs should have a seat at the strategy-making table. That advice is good, but simplistic. There are CIOs who can provide savvy ideas about new business applications but can't drive the kind of business value that the European bank's CFO in our example did. Whether IT leadership ends up in the hands of the CIO or another executive depends on multiple factors, including ability, reputation, corporate culture, and a company's perception of the role of IT. In a recent survey,² few senior executives placed a high degree of importance on guidance in IT matters from the CIO: their top priority was getting business value from IT.

Some CIOs have taken on the leadership mantle. From our ongoing research on CIO relationships in French companies—as well as discussions with other European and US CIOs, CEOs, and business-unit leaders³—it is clear that this transition requires

¹ See Frank Mattern, Stephan Schönwälder, and Wolfram Stein, "Fighting complexity in IT," *The McKinsey Quarterly*, 2003 Number 1, pp. 56–65

(www.mckinseyquarterly.com/links/12969).

² GartnerG2 and Forbes.com, "Key business issues survey: What keeps CEOs up at night?" The analysis of the survey, released in February 2004 on Forbes.com, focused on the responses of 462 senior business executives from large companies around the world.

a new focus plus new skills. CIOs need to direct their attention away from managing IT supply and toward managing IT demand, and they must fine-tune their executive-leadership skills.

From supply to demand

Think of supply and demand, in this context, as a clarifying analogy. CIO responsibilities span a spectrum of managerial tasks, with one end of the spectrum involving supply—the delivery of IT resources and services to support business functions. The other end of the spectrum is demand—the task of helping the business innovate through its use of technology. CIOs who accept the new responsibilities of IT leadership are delegating or even shedding some operational duties and spending more time helping business leaders identify and use technologies that matter. This challenge includes persuading business leaders to be better owners of the technology they leverage. To achieve this goal, CIOs are redefining their roles and changing the way they communicate and lead.

In truth, most CIOs struggle to balance the supply and demand roles. Managing IT supply—keeping the engine running cost-efficiently and reliably—is the heart of the job. Basic systems must be operating smoothly before the CIO can take on broader leadership responsibilities. Most CIOs also spend considerable time with business-unit leaders and other executives in the company and talk to customers, suppliers, and business partners.

But many CIOs admit that managing supply tends to trump shaping demand. Although in survey after survey they say that aligning IT and business strategies remains one of their most significant challenges, they don't have enough time for effective strategic planning.³ They feel demand-side pressures but are hard-pressed to meet them.

While CIOs do spend time with business-unit leaders, numerous executives say that the time is not well spent. They tell us that their CIOs aren't up to speed on issues confronting the businesses and can't think through the implications of systems trade-offs, on a business-unit level, for planned implementations or proposed IT investments. Moreover, business leaders often tell us that their CIOs are not proactively bringing them new ideas

about how technology can help them compete more effectively.

Part of the problem stems from the inherent conflict of managing supply and shaping demand. CIOs often must meet requirements to reduce total IT spending, for instance, while making investments to support future scenarios—even though these upgrades will increase IT operating costs. By trying to be both a cost cutter and an innovator, the CIO sometimes compromises one role. At a financial-services company, the CIO slashed IT supply costs to meet corporate objectives, and now the organization's aging legacy systems fail to provide competitive functionality. The company's business leaders don't understand why IT spending must rise or why it will take a long time to implement needed new functionality.

CIOs who seek a broader demand role also face many organizational challenges. They alone can't drive change in parts of the organization that are under the control of other executives. Business-unit leaders want more IT leadership, but they are wary of CIOs who don't tread carefully along business leaders' boundaries.

Ironically, as business leaders have gained a greater understanding of technology's strategic impact—indeed, during the dot-com years, some even led Internet channel initiatives—they are more likely to engage in battles over ownership of and accountability for IT. Tempers can flare especially vividly during decisions about business-applications investments. At a US-based financial-services company, business-unit leaders went to war with the CIO, one of its top executives, when he attempted to take greater responsibility for IT applications and technology investments at the business-unit level and to make business leaders shoulder more accountability for getting returns from IT.

Leadership agenda

At a growing number of companies for which IT is part of the very fabric of the business, the next IT objective clearly is to make improvements on the demand side. Leadership in this area awaits CIOs or other executives who will step up to

³In a follow-up to a 2002 survey by McKinsey and Club Informatique des Grandes Entreprises Françaises (Cigref) of CIOs and CEOs at more than 70 leading French companies, we are conducting in-depth interviews with business-unit leaders at a subset of these companies.

⁴The most recent survey is "State of the CIO survey," *CIO*, April 1, 2003.

the challenge. What does demand-side leadership consist of? In companies where executives have begun to ensure that the organization captures greater value from IT investments, we see three critical hallmarks of success:

- 1.** Key business executives in the organization—as well as the CIO—have a clear financial understanding of IT costs and potential investments. Business and IT managers who discuss IT in a common, business-focused language make smarter and faster decisions.
- 2.** There is widespread business accountability for IT. Executives who possess a financial understanding of IT are more willing to take responsibility for generating value from IT investments.

- 3.** Business and IT managers seriously study how new technology investments can help a company become more productive and competitive. In other words, they seek innovations that will help them change the business.

For a majority of companies, IT leadership is a vacuum. The CIO should view each of the three markers of success as an opportunity. By taking the lead in making improvements in any one—or all three—of these areas, a CIO can help the organization get significantly greater value out of its IT spending and, in the process, gain credibility to take on even more significant leadership tasks.

What CEOs really think about IT

Most large companies in the United States and Europe have long struggled with the need for tighter relationships between IT and business managers. This perennial management problem is echoed once again in a recent study of how French CEOs and CIOs view the performance of information systems within their organizations.¹ Insights from the study suggest that CEOs are growing keener to find a solution—and that both CIOs and the leaders of business units may soon be held more accountable for business ownership of IT.

In the survey, CEOs say that IT isn't meeting their (admittedly high) performance expectations, particularly in providing systems and tools to support managerial decision making and in gaining the scale advantages of deploying common systems and processes across business units. CEOs attribute the gap between expected and actual performance mainly to the insufficient involvement of business units in IT projects, to the weak oversight and management of these projects, and to IT's inadequate understanding of their business requirements. As one CEO commented, "Because the businesspeople are uninterested in information systems, the information systems people have the power."

CEOs have high expectations that business units will be strongly involved with information systems projects throughout their whole life cycle. Around 90 percent of the CEOs expect business units to identify the IT investments needed to implement their strategies; to support, monitor, and assess important IT projects; and to help make IT-investment and budget decisions as well as the process and organizational changes that technology implementations

require. But the actual involvement of business units is far below expectations: fewer than 10 percent of the CEOs feel that businesses really assess the benefits of IT projects, for example (exhibit).

Moreover, CEOs acknowledge that the governance of IT emphasizes checks and balances more than the strategic use of IT to create value. In most of the companies questioned, the business units allocate resources to information systems on a case-by-case basis. Projects are often run by steering committees that oversee joint teams consisting of managers of business units and IT. Few business units have a permanent sense of responsibility for IT, and the interaction between CIOs and business units is often confined to a few strategic IT committee meetings a year. In half of the companies, the CIO isn't involved in drawing up business-unit strategies, and in most companies, information systems aren't discussed at the board level.

But the most important blind spot is the assessment and monitoring of IT's benefits. The survey reveals that only major projects are subjected to business-case assessments before launch, that only half of the companies monitor the expected benefits, and that the business units are not accountable for realizing them in nine companies out of ten.

The survey does, however, suggest that some CEOs are starting to make business managers more accountable for getting business value from IT. One approach is to give business units ambitious progress objectives, which encourage managers to seek ways of using information systems to meet them. A CEO said, "I try to empower the BUs

Financial language of IT

At companies where business executives are involved in technology-investment decisions, IT leaders aren't generating reports about how many person-days it will take to build functionality into a particular system. Instead they frame IT costs in financial terms. At one company, for instance, the CIO compared the IT capital expenditures of a proposed new system with ratios and returns on other kinds of capital outlays made by companies in the sector. Another CIO routinely groups costs or investments in tangible categories—such as equipment and people—and breaks out how specific changes in the business unit can lower costs or improve an investment's impact.

At a handful of companies, CFOs are starting to push aggressively for changes in the way IT and

the business evaluate and measure information technology. Smart CIOs could forge alliances with their CFOs to sell these changes throughout the organization.

Business accountability

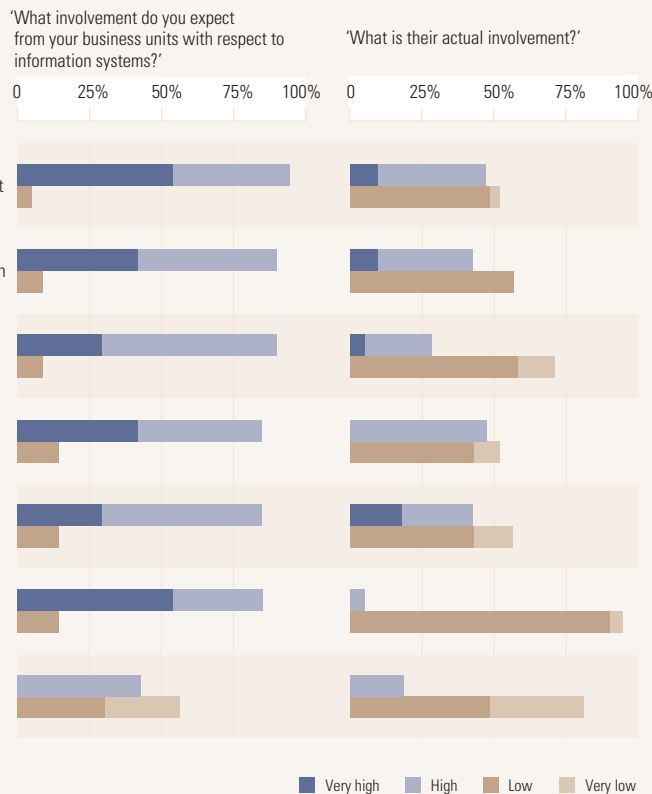
Most executives recognize that active involvement by business leaders in setting the agenda for IT investments improves the company's ability to get the greatest benefit from them.⁵ But involving business executives in investment decisions—much less getting them to take responsibility for realizing the benefits of new systems—has been difficult. There is considerable room for improvement. In a 2003 McKinsey survey, 64 percent of CIOs reported that their IT budgets were set at the beginning of the year and that they didn't have to compete with business units

⁵Dan Lohmeyer, Sofya Pogreb, and Scott Robinson, "Who's accountable for IT?" *The McKinsey Quarterly*, 2002 special edition: Technology after the bubble, pp. 38–47 (www.mckinseyquarterly.com/links/12971); and Jed Dempsey, Robert E. Dvorak, Endre Holen, David Mark, and William F. Meehan, "Escaping the IT abyss," *The McKinsey Quarterly*, 1997 Number 4, pp. 80–91 (www.mckinseyquarterly.com/links/13165).

EXHIBIT

Expectations not met

% of respondents



Source: 2002 McKinsey and Club Informatique des Grandes Entreprises Françaises (Cigref) survey of CEOs and CIOs of >70 leading French corporations

[business units] and have them make commitments. We monitor them and apply pressure through benchmarks. For finance [the cost of financial processes], for example, the benchmark was set at 0.8 percent of total income and we gave them 18 months to achieve it. . . . The division bosses weren't the least bit interested, but they realized that they couldn't achieve their continuous-progress objectives if their division wasn't equipped with performing information systems. In less than six months, we saw a genuine change."

Other approaches used by CEOs to get business managers more involved in IT decision making include putting information systems issues on the agendas of executive committees and initiating the development of master plans for integrating the strategies of information technology and business units.

¹The study—conducted jointly in 2002 by McKinsey and Club Informatique des Grandes Entreprises Françaises (Cigref), to which a majority of the largest companies in France belong—was based on interviews with or questionnaires from the CEOs and CIOs of more than 70 leading French corporations.

or other functions for resources. Also, 68 percent of these companies had no process for auditing the performance of their IT projects. An additional 14 percent said that while their companies did have a postimplementation audit process, outcomes weren't tied to budgets or bonuses (see "Tech spending is up, but who's doing the buying?" *McKinsey on IT*, Number 2, Spring 2004, pp. 9–12).

Despite these organizational constraints, CIOs can drive changes in accountability. At a basic level, many CIOs can do postimplementation audits themselves. More generally, a few CIOs have led broad change initiatives—restructuring global IT organizations, for example—that have prompted businesses to take on greater responsibility for IT decisions. (For a look at how one CIO achieved this result, see "Deutsche Bank's IT revolution," *McKinsey on IT*, Number 2, Spring 2004, pp. 18–22.)

Innovation

Business-unit leaders we spoke with worry that they don't have a good grasp of which new technologies to scrutinize and which to ignore. Are any emerging technologies potentially disruptive—that is, could they help a company change the competitive game? And how, specifically, might the business units take advantage of new technology?

Charlie Feld, the former CIO of Frito-Lay, Delta Airlines, and First Data Resources, argues that CIOs must be able to cut through complex tangles of business and technology signals to see—as an innovator would—patterns and meaning and to distinguish opportunities from fads.⁶ That vision is one of the skills required for demand-side leadership.

The CIO of a large European construction company says that his role within the organization is to be the "chief innovation officer." He spends considerable time studying the use of technology by European and North American companies in order to find new solutions—for example, ways that technologies used in other sectors can be recast to pioneer trends in building and construction.

Making the transition

CIOs who drive improvements in one or all three of these areas will need to focus less on operational issues and more on becoming business leaders. In our discussions with CIOs, business-unit leaders, and executives, we have identified a few important practices that can help CIOs succeed at this challenge.

Ensure that IT is efficient and then make the transition to effectiveness

For some CIOs, the first step in the transition from supply-side to demand-side leadership is to verify that the IT department is in good financial and operational order. As a North American energy company CIO put it, "If you can't keep basic systems up and running, you can't talk about strategy."

The dilemma for CIOs is that ensuring efficiency requires one set of management approaches and focusing on effectiveness quite another, so new skills are needed and very different priorities must be set. In mastering efficiency, CIOs are often pushed to be project oriented and to concentrate on the short-term actions needed to make targeted improvements or to put out fires. Communication with business units often emphasizes action plans and progress.

When the IT engine is running smoothly and the CIO turns his or her attention from supply to demand, the required management capabilities change—from operational skills to strategic ones, from short-term horizons to longer-term ones, from IT communications to business communications. CIOs need to know not only what the differences are but also how to time the shift; move too soon or too late and credibility with business leaders will suffer.

To be sure, some CIOs won't make the transition successfully. Those who do will spend less time managing core operations, be better able to describe the performance of the infrastructure in business terms, and spend more time creating real business value from IT.

⁶Charlie Feld, "IT leadership in 2010," *CIO*, December 15, 2003.

Reengineer relationships with business leaders

For CIOs who have efficiency in order, the first step toward effectiveness is to build strong relationships with business leaders. The current supply-side model of IT leadership doesn't help CIOs forge these connections. In many companies, IT staff undertake discussions with business units about their requirements while the CIO largely stays at home managing supply. The reverse needs to happen.

Even CIOs who spend time talking with business leaders often need to digest the experience. Each discussion is an opportunity to forge a common financial understanding of IT. Successful demand-side CIOs leave IT measures and operating reports at the door; they know that providing business leaders with unwanted information only reinforces negative opinions about IT. Instead they ask about the business—and they listen. Executives have different opinions about the level of information they want, and smart CIOs figure out how to accommodate these differences within a common financial language.

As part of these discussions, CIOs should provide insights about how technology can help the business develop new capabilities. A few CIOs who do this well sometimes frame these discussions around what their competitors are doing—they have become adept at business intelligence. The CIO at one bank, for instance, routinely interviewed managers who were newly hired from competing banks about technology and business issues.

Invest a business committee with technology oversight

A few leading companies have disbanded their technology committees—typically staffed by business managers and IT staff—and are asking senior-executive committees to take responsibility for IT-investment decisions. They found that technology committees had limited usefulness. Indeed, business managers often sent delegates in their place, thus

undermining the group's continuity and typically shifting the perspective toward IT.

Instead these companies ask existing top-executive committees to add technology to their agendas. (At two such companies, the CIO has earned membership; at others, the CIO is an invitee.) Over the years, these executive committees have worked to make effective decisions quickly. As they learn about technology, they apply the same decision-making process. Executives at companies with such a committee don't send substitutes to meetings, and all decisions about IT projects go through it. Using this structure avoids the problems (such as encroaching on the space of other committees and making conflicting decisions about IT) that companies have when multiple committees are responsible for different aspects of technology investments.

Ultimately, some CIOs may need to shed—partly or wholly—their supply responsibilities. The CIO of a European industrial company is beginning to outsource most of its supply-side organization so that the remaining IT managers can focus on demand-side activities. One European insurance company recently replaced a supply-oriented CIO with a new one who sits on the company's executive committee and has no responsibility for supply.

The pressing need to get better business value from IT calls for technologically savvy business leaders. Now is the time for CIOs to step up to the role—the challenges are many, but the opportunity has never been more ripe.

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