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Strategic CIOs Link Cost Optimization to Business Outcomes

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Initiatives: IT Cost Optimization, Finance, Risk and Value

CIOs must engage in strategic cost management approaches extending beyond short-term cost-cutting activities, and provide programmatic and systematic improvements that enable the enterprise’s mission.

Overview

Key Findings

- When faced with the challenge to manage costs, many CIOs resort to cost cutting, with little to no strategic focus or understanding of the long-term business impact.
- Cost management initiatives that start as an exercise in immediate spending reduction typically end that way.
- CIOs typically seek to support business objectives in the long term, but are hampered by poor communication, resistance to change, competing incentives, urgency and isolated optimization planning. CIOs must address all of these as part of an optimization strategy and program.
- Cost management programs are an opportunity to gain support for initiatives, prioritize future business benefits, and execute collaborative, organizationwide projects.
- Successful cost management programs have common features. CIOs apply these features in a multipronged approach in their domain and determine how to support counterparts.

Recommendations

As a CIO charged with guiding IT cost management efforts, you should adopt a strategic cost optimization approach, and:
Analysis

Make Cost Optimization Both Strategic and Programmatic

When optimizing costs, CIOs must consider the needs, aims and experiences of other functions and business units. A strategic and long-term view of cost management, organizational dynamics and economic circumstances will help avoid reactive, cost-focused conversations.

CIOs must have a plan and the discipline to manage costs in a programmatic and repeatable way. Perhaps the enterprise is responding to a sudden lag or loss in revenue, or the industry is adapting to new regulations. Maybe the geographic region is growing politically unstable. In such times, decision making is clouded by stress and confusion. Cost-cutting approaches are not sustainable and are seldom strategic.

The challenge for many organizations is to develop a common language and structured approach to cost management. That is, to reduce when required but also to proactively optimize costs and, ultimately, invest in business value with the resulting proceeds.

CIOs must embrace both optimization and reduction as approaches to cost and spend management. A strategic approach would be to build an ongoing optimization program that is designed to be proactive, programmatic and strategic (see Figure 1).
Figure 1: The Three Disciplines of Strategic Cost Optimization

The Three Disciplines of Strategic Cost Optimization

<table>
<thead>
<tr>
<th>Cut Costs</th>
<th>Optimize Performance</th>
<th>Invest to Grow</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reactive, Short-Term Immediate Reductions</td>
<td>Programmatic, Structured Improvements</td>
<td>Business-Value-Driven, Stakeholder Partnership</td>
</tr>
</tbody>
</table>

- Cut costs in areas no longer fit for the postpandemic world
- Optimize in parts of the business that you want to protect
- Invest in new capabilities that are required for the postpandemic world

Table 1 highlights the key considerations of each strategic cost optimization discipline. Organizations should approach strategic cost management as an expansive effort that can have immediate and long-term significance to business performance. IT strategic cost optimization demands a mix of approaches and improvements that touch every part of the enterprise if it is to truly serve the enterprise.
Table 1: Cost and Value Optimization Versus Cost Cutting

<table>
<thead>
<tr>
<th></th>
<th>Cut Costs</th>
<th>Optimize Performance</th>
<th>Invest to Grow</th>
</tr>
</thead>
<tbody>
<tr>
<td>Catalyst</td>
<td>Economic pressures — conserve cash/increase profitability</td>
<td>Stewardship — do more with current resources</td>
<td>Business outcomes — drive greater business impact</td>
</tr>
<tr>
<td>Approach</td>
<td>Ongoing cost review and reduction of low-value or underutilized spend</td>
<td>Strategic — planned and programmatic discipline</td>
<td>Partnership — ongoing business outcomes</td>
</tr>
<tr>
<td>Goal</td>
<td>Protect cash flow and improve profitability and/or actively harvest spend and reinvest in more productive digital opportunities</td>
<td>Structurally shift existing resources to more strategic outcomes</td>
<td>Partner across the business to invest in high-value business outcomes</td>
</tr>
<tr>
<td>Barriers</td>
<td>Absence of financial transparency</td>
<td>Immature financial management</td>
<td>No definition of value</td>
</tr>
<tr>
<td></td>
<td>No leadership support</td>
<td>Limited time and interest</td>
<td>Lack of agility</td>
</tr>
<tr>
<td></td>
<td>Not sustainable</td>
<td>Perceived lack of value and benefit</td>
<td>Limited trust</td>
</tr>
<tr>
<td></td>
<td>Time pressures</td>
<td></td>
<td>No proven track record</td>
</tr>
<tr>
<td>Results</td>
<td>Rationalization and reduction/reallocation of spend</td>
<td>Ongoing discipline of optimizing operations</td>
<td>Sustainable investment/reinvestment of funds in superior business outcomes</td>
</tr>
<tr>
<td></td>
<td>Delay or cancel projects that do not have demonstrable impact on business value</td>
<td>Freeing of resources for reinvestment</td>
<td>Stronger business engagement</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Programmatic reinvestment of resources into business impacting investments</td>
<td>Increased strategic relevance for IT</td>
</tr>
<tr>
<td>Risks</td>
<td>Negative business impacts when projects are defunded</td>
<td>Low interest during positive economic climates</td>
<td>Increased spend without gain</td>
</tr>
<tr>
<td></td>
<td>Spend often shifting or subsequently returning without gain/benefit</td>
<td>Time availability and ability to execute</td>
<td>Ineffective prioritization and value realization</td>
</tr>
<tr>
<td></td>
<td>Failure to understand or communicate impact</td>
<td>Interest asset optimization requires effort and discipline</td>
<td>Failure to understand or communicate impact</td>
</tr>
</tbody>
</table>

Source: Gartner (December 2021)

Make Strategic Cost Optimization an Ongoing Discipline

The first step is to identify where you are in the strategic cost optimization journey, and then define a plan to become increasingly focused on value optimization. The plan needs to define the overall approach, select and prioritize specific initiatives, and define targets and milestones. Planning needs to be centrally coordinated and managed by the CIO or a direct report.

While all CIOs have options available to them in deciding their overall approach to cost management (see Figure 2), the objective of most should be to undertake it strategically. The approach needs to be informed by the specific objectives and outcomes of their own cost management program.
The three main components to IT strategic cost optimization are cutting expenditures, conducting structured cost optimization and investing for value. These phases are not mutually exclusive. The best practice is to routinely, and culturally, address all three as part of a strategic cost management program.

**Cut Costs**
Thinking of cost cutting simply as a reactive action required to address severe business risks is a common trap. Even in good times, CIOs should diligently review and cut spend that does not have a demonstrable impact on business outcomes. Enterprise survival or reducing spend to achieve profitability goals will force executives to conduct emergency, reactive or immediate spending cuts. Mature and strategic cost management should be undertaking all three, continuously. As the tech landscape, service delivery and technical capabilities shift, there will always be things that should be cut from a budget. Technical advances drive new processes, creating opportunities for optimization. Changes in strategic priorities, or approaches to implementing them, also should be the focus of IT investment.

Too often, cuts are made independent of the value delivered. The goal must be to cut spend to increase profit. Even in times of relative plenty, IT should look for ways to cut spend to reinvest in projects that drive increased business value.
In executing cost cutting, there are three main techniques that can be deployed. Each technique delivers specific cost cuts for the organization. These techniques can be, and commonly are, deployed at the same time to different parts of the cost base. The key techniques in cost cutting include:

- **Targeted cost reduction and elimination.** Here, executives review the cost base via the general ledger accounts, and reduce or even eliminate specific cost items or categories.

- **Straight-line reductions.** Here, executives institute a flat (say, 10% to 15%) reduction strategy of the budget, year over year, for up to a three-year period. This approach is not targeted to any cost element in particular and is applied across the board. This approach can force staff to prioritize the largest and most achievable spend reduction, regardless of value impact/implication.

- **Radical cost reduction.** Here, executives take radical steps not only to remove cost from budgets, but also to bring down actual spend. Activities are ceased in order to reduce year-over-year spending. This could involve elimination of ongoing projects, products and departments, regardless of value.

In executing cost cutting, there are three main techniques that can be deployed. Each technique delivers specific cost cuts for the organization. These techniques can be, and commonly are, deployed at the same time to different parts of the cost base. The key techniques in cost cutting include:

- **Eliminate.** Eliminate an item of expense from the cost pool. Examples include ceasing to perform low-value activities, retiring old systems and underutilized applications, and canceling external services or subscriptions.

- **Rationalize.** Reduce the use or consumption of services and associated costs. Examples include removing duplications and redundancies (hardware, software and activities), reducing the number of vendors, and reducing the number of seats or users and subscriptions.

- **Renegotiate.** Reduce supplier pricing. Examples include renegotiating enterprise purchasing or supply agreements and market testing externally provided services.

In all cases, cost reduction activities are most effective when the true cost driver is identified and eliminated or permanently reduced. This serves to prevent the cost from returning or moving to another part of the budget. However, even in emergency situations, executives should assess the business value against the amount of expected savings (see 10 Rules for Rapid IT Spend Reduction, How to Demonstrate IT Cost Management Success and Leverage IT Financial Controls to Accelerate IT Cost Management Objectives).
Optimize Performance

When the executive leader faces a less pressing and longer time frame, we recommend a more structured and sustainable approach. In all cases, the executives should benchmark and identify which functional or business areas have cost variances that are significantly higher than vertical industry averages. Leaders should develop a programmatic approach to structured cost optimization in which they review their spending by relevant categories to reduce and reallocate spending where cuts will have the least negative impact on business value (see The Gartner Cost Value Matrix: Optimize IT to Fund Digital Business Acceleration).

Optimization demands broad thinking, yet narrow perspectives often prevail.

Improve Efficiency

CIOs should focus their IT teams on doing what they currently do better and enable the rest of the business to do the same. Approaches include:

- **Simplify the delivery of services, processes and business outcomes.** Examples include defining common and repetitive tasks, identifying and documenting service delivery requirements, and simplifying the delivery of services to common best practices.

- **Standardize.** Establish common processes, systems and providers. Suppress the variability of workloads and business activities.

- **Centralize.** Seek economies of scale, leverage highly skilled resources and reduce duplication. Colocate resources, services and assets. Reduce management levels and reduce real estate needs.

- **Share.** Establish shared services across organizational units or organizations. Improve service delivery and satisfaction outcomes.

- **Automate and enable processes.** Examples include reducing human involvement in redundant and repetitive tasks, automating delivery, increasing or enabling self-service, and dedicating resources and funding to support automation initiatives.
Increase Productivity

CIOs must invest resources to develop a culture of striving to do more with what they have — shifting effort and expenditure from lower-value to higher-value business work:

- **Better utilize existing resources.** Examples include averaging out workloads across assets and load balancing, increasing virtual density, and expanding the utilization of current systems and tools.

- **Realign labor resources.** Shift labor savings achieved in efficiency efforts from basic, low-level functions to more-value-oriented and complex deliverables.

- **Prioritize and reassign projects and spend.**

- **Outsource processes and functions.** Move commodity work to lower-cost external providers, and focus internal resources on strategic and value-added processes.

**Shift Spend**

CIOs must help their IT team(s) identify and adjust resource allocations to achieve more from their current spend. There are several approaches to strategically optimize costs, and free up funds and resources for increased value optimization that should be explored:

- **Simplify the complex.** Offer fewer and less complex options around processes, systems or tools, where possible. The support of multiple options is an exponential, rather than linear, compounding of support costs.

- **Rationalize.** Reduce the use or consumption of services and associated costs. Examples include removing duplications and redundancies (hardware, software and activities), reducing the number of vendors, and reducing the number of seats or users and subscriptions.

- **Renegotiate.** Reduce supplier prices. Examples include renegotiating enterprise purchasing or supply agreements and market testing outsourced services.

- **Evaluate.** Anticipate and assess the impact of the reductions on the organization. Consider this in terms of financial performance, and customer and employee impact.

For more information, see Ignition Guide to Identifying and Prioritizing Cost Optimization Opportunities as a CIO and Create and Communicate an Enterprise Cost Optimization Roadmap.
**Invest to Grow — Optimize Value**

Top-performing CIOs will never cost-cut their way to enterprise-level strategic relevance. They extend their cost optimization efforts to focus on investing resources to drive business outcomes. By managing costs more strategically and programmatically, they’re delivering value to the business — even in economic or business downturns.

**Align to Value**

CIOs must lead the realignment of expenditure to the delivery of business-valued products and services. This requires:

- Ongoing stakeholder engagement
- Productizing solutions into units of consumption that the consumer/stakeholders understand and value
- Documentation and validation of stakeholders’ desired outcomes — ensuring that the stakeholders’ needs and expectations are correctly captured

Success in the delivery of value comes from understanding stakeholders’ needs and desired outcomes. IT leaders must partner with stakeholders to define what is valued, identify and resolve the pain, and realize that the stakeholders own the return part of the ROI analysis.

**Plan and Prioritize**

Technology leaders should work with business stakeholders to build and validate a justifiable business case that:

- Defines business-valued products and services
- Prioritizes investment based on the business’s mission
- Defines success clearly in a document that is socialized and approved by stakeholders
- Funds projects based on quantifiable measures like ROI for new or grow/transform projects and price for performance for operational or run spend
If there isn’t an effective project management office (PMO) and investment management body, CIOs must establish a decision framework or criteria to prioritize projects based on impact to the business mission. This will allow better business engagement and increase defensibility for project prioritization decisions. The goal is to reach agreement with stakeholders and business leadership on which investments are made and in what order. Then, CIOs must prioritize the needs relative to their impact on business outcomes (for example, value creation, cost-efficiency optimization and risk mitigation).

Project funding should not be based on available funds or the urgency of the request, but rather on the impact on a business outcome or the enterprise’s mission. Fund the most impactful outcomes first.

**Execute and Measure**

CIOs should work within the PMO to establish a process to formally document the plan, communicate changes and evaluate value contribution against forecasts. Changes to the plan can’t be ad hoc. They should be supported by documented roadmaps and approved justification to which business stakeholders and sponsors commit. Adopt the following best practices:

- **Validate iteratively.** Much like in an agile development effort, check back often with stakeholders to ensure that the documented needs are being met and that no course correction is required.

- **Measure impact, not work.** Measuring the impact, rather than detailing the chronology of the work completed, will allow the stakeholder to better understand progress against the documented objectives.

- **Communicate incremental value delivery.** Whenever possible, communicate impact to the objective or mission.

**Iterate and Innovate**

CIOs should actively evaluate progress, reassess stakeholders’ needs and adapt to changing requirements in an agile approach. Listen and react to customer needs, and be agile and flexible:

- **Refine.** Evaluate and fine-tune the direction and objective of projects and deliverables constantly.

- **Realign.** Allow adjustments to investment portfolios to maximize value to the organization’s mission.
For more information, see Create a Culture of IT Smart Spending, Securing Digital Growth Investments in the Long-Term and Case Study: Cost Optimization to Fund Digital Transformation (Oregon State University).

Collaborate and Build Support With Business Leaders

As CIOs and their leadership teams begin the cost management journey, programs and initiatives frequently operate in functional silos. Typically, the details are shared only with a few team members, and the process is isolated from other business units, which have their own, equally significant objectives. While the components and elements of functional programs are distinct, functional leaders often set out on cost management initiatives with a considered and structured approach.

Under time and cost pressures, CIOs take cost management actions that can jeopardize enterprisewide strategic priorities, like preserving revenue, continuing to innovate and retaining key staff. Organizations will be well-served by adopting approaches that support a recurring, collaborative effort to optimize costs. Experience tells us that enterprises that survive cost pressures do things differently.

These enterprises:

- **Refocus.** Move quickly to change directions when the business case is justified. Adapt dynamically to new needs and new priorities, and adjust prioritizations and disposition investments quickly.

- **Retire.** Be willing and able to terminate projects quickly by eliminating the use of the word “failure” and replacing it with less-fear-inducing terms, such as “learn” and “experiment.”

Prepare for cost management at least once a quarter, ideally a year before the need for such measures is obvious.

- Look beyond the short term and avoid knee-jerk reactions, such as large layoffs.

- Recognize that cost cutting is not a growth strategy, but one of survival.

- Maintain revenue by taking the opportunity to rethink their products, pricing or channels.
CIOs engaging in cost reduction must prioritize business objectives, such as growth and revenue targets. They must also account for constraints, such as time and resource availability, and identify the various courses of action and approaches that balance complex competing forces.

Cost management efforts should include a number of key elements:

- **Gain a broad perspective.** Think more broadly than the impact to just a specific functional group, considering the overall business and business strategy. For example, along with cutting travel, training and communication expenses, reducing staff is often among the first things that organizations do when they need to reduce expenses. However, costs and risks are associated with reductions in the workforce. HR departments can share essential information and provide critical process expertise and alignment across business units, ensuring that staff reductions really make sense.

- **Obtain support.** Cultural and political barriers are common impediments to successful optimization. The lack of engagement with stakeholders and peer executives around cost management priorities puts investment prioritization, planning and implementation at risk. Ensure that the process for selection and prioritization is clear, communicated and consistently applied.

- **Avoid conducting reductions in a functional silo without communication or collaboration between business units.** An ideal approach would consider the reduction of expenses of a vital success function and gain cross-functional support. For example, you may ask, “How can we reduce the total cost of the services we are providing our customers?”

- **Achieve transparency.** This should be a key priority for CIOs who seek to determine the effectiveness of an optimization effort. Organizations that have only traditional, high-level views into budgets often fail to successfully identify and communicate the impact of budget reductions beyond the movement in the bottom line. Overall, business stakeholders struggle to visualize the impact of reducing spending on specific assets. Stakeholders can, however, relate to a discussion around whether the enterprise should reduce spend on, say, business continuity versus collaboration services.
CIOs’ priorities must ensure that essential “run the business” processes are sustained, identifying critical projects that deliver business value; protecting key talent; and distinguishing between budgetary line items to cut, reduce, outsource and defend. CIOs are prudent to consider numerous areas for potential optimization activity. Such an approach may require an initial investment but can drive future cost reduction and maximize business outcomes. This can be achieved by automating business processes and information delivery, and by optimizing the use of processes, resources and existing capacity.

Taking a proactive approach to cost management enables CIOs to embed the process as an ongoing discipline. This makes reallocating scarce funds to the most valuable business outcomes part of the organization's identity and culture.

In summary, CIOs must:

- Start IT cost management initiatives with a clear recognition of business priorities, and move quickly to a structured and programmatic discipline that prioritizes them.
- Account for constraints, such as time and resource availability, while striking a balance between the various courses of action and approaches that address the complexity of competing forces.
- Leverage the Gartner Cost Management model to address cost management as a thoughtful and well-planned journey from reactive cost cutting to programmatic management and a culture of value optimization.

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**Recommended by the Authors**

Recommended by the Authors

Some documents may not be available as part of your current Gartner subscription.

- Strategic Cost Optimization Score for IT
- Tool: IT Cost Optimization Status Check
- Strategic Cost Optimization: Link Cost Decisions to Strategic Priorities
- 12 Rules of IT Cost Management
- 10 Rules for Rapid IT Spend Reduction
- How to Communicate Value in the Languages of IT, Finance and Business Outcomes
Actionable, objective insight

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Insights, advice and tools to help CIOs address their top challenges.

**Research**
The Gartner CIO Agenda
Leadership, organizational and technology priorities CIOs must address.

**Tool**
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